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HOUSING AND COMMUNITY DEVELOPMENT LEGISLATION—1973

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OF HOUSING AND URBAN DEVELOPMENT

PART 3

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HOUSING IN THE SEVENTIES

(V)



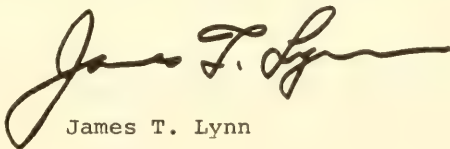
THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20410

October 6, 1973

This report is a product of the National Housing Policy Review. The Review was undertaken to serve as the basis for new housing policy recommendations as promised in President Nixon's State of the Union Message on Community Development dated March 8, 1973. The President's housing recommendations are set forth in his Message of September 19, 1973.

The report will be presented in two parts. Part 1 is an eight-chapter description and analysis covering such matters as the Federal Government's involvement in housing, both direct and indirect; the suspended federally subsidized housing programs; the housing activities of state and local governments; the production, finance and cost of housing; and the structure and technology of the housing industry. Part 2 will contain some of the technical and background papers produced for the National Housing Policy Review.

Part 1 in the attached form is for the immediate convenience of Members of Congress. Final editing of Part 1 for printing and publication by the Government Printing Office will be completed shortly.



James T. Lynn

(VII)

Introduction

A. Historical Perspective

From very modest beginnings barely forty years ago, the presence and influence of the Federal Government in the ways Americans build, finance, manage, and maintain their housing have grown dramatically. Today there is not a single significant aspect of the vast, diverse and complex housing market which is not affected by governmental action in one form or another.

This phenomenon is particularly remarkable when one considers that for over a century and a half, from agrarian times through the growth into an industrialized and increasingly urban society, the Federal Government had left the problem of housing up to the individual and the private market. This attitude changed in the mid-1930's, primarily as a result of the Great Depression, and from that point on hardly a year went by that the Congress did not pass some new form of housing legislation.

In the 1930's Congress made two fundamental policy decisions which remain basically intact to this day. The first was the complete restructuring of the private home financing system through the creation of the Federal Housing Administration (mortgage insurance); the Federal Home Loan Bank Board and Bank System (savings and loan industry); institutions like the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation (insurance on deposits of commercial banks, mutual savings banks, and savings and loan associations); and finally, the Federal National Mortgage Association (secondary mortgage market). Creation of these institutions, resulting in the acceptability of the long-term, low down payment, fully amortizing mortgage and a system to provide a large flow of capital into the mortgage market, are probably the most significant achievements of the Federal Government in the housing area.

The other fundamental policy decision in the same decade was the concept of Government-subsidized housing for low-income families. Although the public housing program authorized in 1937 was intended primarily as a means of stimulating employment and clearing slums, it nonetheless marked the first time that Federal funds were used to finance new housing construction for the less fortunate.

In the years that followed, numerous Federal housing and housing-related programs were added to the statute books, spurred by the 1949 enactment of the national goal

of "a decent home and suitable living environment for every American family." A number of mortgage insurance programs conferring special benefits on such groups as veterans, farmers, the elderly and those displaced by other Government programs were added. Those programs were, in turn, followed by new subsidized mortgage insurance and subsidized direct loan programs benefiting the elderly, the poor and the near-poor.

In 1968 Congress found "that the supply of the Nation's housing is not increasing rapidly enough to meet the national housing goal, established in the Housing Act of 1949, of the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family." To meet the goal, Congress established a production schedule "within the next decade of the construction or rehabilitation of twenty-six million housing units, six million of these for low and moderate income families" and enacted a further set of programs to assist in meeting the production schedule for low and moderate income families. These new programs conferred further special benefits, including deeper subsidy assistance for home ownership and rental housing, on residents of rural areas and declining inner-city neighborhoods, and on lower income families.

B. The Suspension and the Study

The Nation is now at mid-course in the decade-long schedule laid out in the Housing Act of 1968, and thus the time is appropriate to take stock of where we have come from and where we are going.

For the years 1969 through 1972, the Federal Government committed subsidy support to provide housing assistance to an additional 1.6 million American families of low and moderate income. This represents more subsidized housing assistance than the total provided by the Federal Government during the entire 34-year history of our national housing program preceding this Administration. This Administration, in response to the 1968 legislation, also has underwritten high-risk mortgages on more than 150,000 units in inner-city neighborhoods, another record achievement.

But these achievements have not been without their drawbacks. The subsidized housing programs enacted in 1968 have developed many basic inequities: comparable subsidy benefits are not being provided for all those with comparable problems; many moderate income families benefit while most lower income families do not; and millions of people with incomes only slightly above those of program beneficiaries

live in units newer and better than those which they themselves can afford.

The programs have turned out to be very expensive, the estimated total cost over the next 40 years to the Federal Government including taxes forgone being \$86 billion. At the same time, the programs are very wasteful. They too often cost the Federal Government more than private sector action would cost to produce the same services. Even those of the income levels intended to be served place a smaller value on these programs than their cost to the Federal Government.

Indeed, the problems became so widespread and so troubling that early this year President Nixon instituted a reassessment of all Federal efforts in the housing field. At the same time, the President suspended the operation of the principal subsidized housing programs for the limited time necessary for such study and evaluation.

In his March 8, 1973, State of the Union Message on Community Development, President Nixon stated: "One of my highest domestic priorities this year will be the development of new policies that will provide aid to genuinely needy families and eliminate waste."

HUD Secretary Lynn instituted the National Housing Policy Review, to be directed as a first priority by Michael H. Moskow, Assistant Secretary for Policy Development and Research, to review and evaluate existing housing programs, identify alternative approaches and develop policy recommendations for the nation's future housing policy. The study was designed to focus on the following:

- (1) the current roles of the Federal Government in housing and housing finance - are they complementary or conflicting? What have been the effects of these roles? How efficiently have they been performed?
- (2) What should be the role of the Government in housing and housing finance?
- (3) What changes in policy and programs are necessary to achieve the appropriate role of the Government in housing and housing finance?

Every effort has been made to make the housing study as thorough and comprehensive as possible. The study has embraced the housing activities of 11 Federal agencies which operate in this policy area and the corresponding

legislation drafted over the years by 12 Congressional Committees that write laws substantially affecting housing. The study has considered the roles played in housing production and finance by the Federal Government, the regulatory agencies, and private institutions and organizations.

More than 100 analysts worked on the review. They were drawn from the Departments of Agriculture; Commerce; Health, Education, and Welfare; Housing and Urban Development; Labor; and Treasury; and from the Veterans Administration, the Federal Reserve Board, the Federal Home Loan Bank Board and the Office of Economic Opportunity as well as from the academic community. The Office of Management and Budget, the Council of Economic Advisers, and the Domestic Council also participated in the study. Emphasis was placed on the development of as much original data as possible within the existing time constraints.

At the same time, efforts were made to work as closely as possible with Members of Congress who are knowledgeable in this field, and with the staff members of Congressional Committees. Similarly, extensive consultations were held with public and private interest groups that have contributed their expertise and energies to this difficult policy area over the past years.

In addition to publishing a request for views in the Federal Register, written requests for comments or assistance were directed to 125 organizations. Over 500 documents and letters were received, thoroughly analyzed, and incorporated into the review.

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CHAPTER 1

FEDERAL GOVERNMENT'S ROLE IN HOUSING

The complex and many-faceted role of the Federal Government in housing had its origin basically in a single great event: the collapse of the housing economy during the Great Depression of the 1930's. The crisis which resulted from that collapse evoked a series of Governmental initiatives which have followed one upon another in the years since.

The history of the Government role from 1932 to 1973 is intricate and tangled. It is possible, however, to construct a somewhat systematic account of the reasons, rationales or motivating forces behind the various housing initiatives and thereby throw some light on the forms in which those initiatives were cast.

There are three broad areas of concern that have guided Government actions in the housing field: 1) recognition that it had a responsibility to maintain and promote economic stability, 2) a social obligation to help provide for those in need and, 3) an emerging interest in how the country's communities developed.

These concerns developed gradually as a result of the economic chaos that accompanied the Depression, replacing earlier notions that the proper role of government was minimal interference in the way the marketplace operated. In reaction to the economic crisis, the Congress and the Executive Branch of the Government developed their separate themes which have evolved through the years into a body of policy and programs with specific themes and sub-themes that in some cases have lost touch with original objectives.

It is possible nevertheless to recognize several of the different economic objectives or motivations underlying Government actions in the housing field.

First, housing has long been considered by some observers to be an important element of any counter-cyclical economic strategy. In times of economic recession, special measures designed to stimulate the production of housing have been undertaken to stimulate construction in general, thus reducing unemployment and

generating a major multiplier effect through increased demand not only for lumber and other construction materials, but for household furniture and fixtures and similar consumer goods as well. Indeed, such diverse programs as public housing and mortgage insurance originated as parts of a massive Government effort to start up a stalled economy and to get the unemployed back to work. Conversely, in times of prosperity housing and housing related industries have been seen by some as a major element of any strategy designed to maintain economic growth and stability. This view has been expressed many times -- as, for example, in the 1968 declaration of a 10-year housing production goal, which was intended to help stabilize the housing economy at levels of sustained high production.

Second, many believe that housing could not play an appropriate role in the economy unless the Government took effective steps to maintain a sufficient and continuous supply of mortgage credit. While this objective has never been successfully realized over long-sustained periods, it has lain behind such major government initiatives as the creation of the Federal Home Loan Bank System, insurance of savings in home mortgage lending institutions, and the creation of the Government-backed secondary market system for home mortgage credit.

Third, it was believed that without Government intervention it was unlikely that housing production would reach and maintain levels high enough to meet the needs of new family formations and to replace slums and sub-standard housing. The Government has therefore sought through many devices such as mortgage insurance, extension of its own credit and technological research to stimulate and expand housing production. These actions were taken not solely for economic reasons but also for the social purpose of providing more and better housing.

The Government's recognition of its obligations to the social needs of the Nation, and especially to the disadvantaged, has expressed itself in a variety of ways in Federal housing policies. An example is the belief displayed in Government policy since the inception of its housing activities, that homeownership is a valid objective of public policy in and for itself. Thus, making homeownership feasible to the widest range of family incomes has been a continuing goal of Government policy. In addition, where the poor are concerned, it has long been recognized that shelter is as basic a need as food. Many efforts have

flowed from this recognition -- public housing, rent supplements, the rental and homeownership interest subsidy programs, and others. Out of these programs has arisen a certain ambiguity as to whether these efforts essentially serve social ends, or economic objectives, or both.

Another example of how Federal housing policies have taken on social objectives as well as economic objectives is in the area of civil rights. With the abandonment of the separate-but-equal doctrine in public education and the emergence of a new national consciousness in the area of civil rights and equal opportunity, the Government has moved from a posture of non-involvement where housing was concerned to one of positive action designed to end racial discrimination in housing and assure equal access to the housing market by all, without regard to race or national origin. And most recently through project site selection policies, the Government has attempted through its subsidized housing programs to reduce racial concentrations in center city slums.

Still other areas of Government social concern can be cited. For example, the Government has sought to provide aid for such special groups as veterans, the elderly, the handicapped and students and has assumed a moral obligation to those who were involuntarily displaced by its power of eminent domain in pursuit of certain public objectives. In recognition of this obligation, a variety of housing programs have been used by the Government to relocate those who have been displaced.

Finally, permeating the thinking of the Congress and the Executive Branch relating to housing has been concern over community growth and development and what the cumulative effects of growth patterns would be on the welfare of the Nation as a whole. This concern has been expressed many times and in many forms.

Public housing originated in 1937 as an effort to clear slums, as much as to increase employment, and assist the poor. Then in 1949, the Congress authorized a major program apart from the public housing program to deal with slum clearance as such. Still later, starting in 1954 and continuing in the 1960's and early 1970's, the same thrust was steadily expanded to embrace ever-larger areas: first, entire neighborhoods, then whole sections of cities, and finally entire cities and counties and pre-planned new communities.

The abundance of Federal housing policy goals helps explain why there has never been unity and coherence, either in housing and community development programs or in administrative organization, for carrying the goals into effect. The manifold objectives imply and to some extent result from a similar number of constituencies to be listened to and served. These constituencies are both local and national, public and private. They represent public interest groups or private interest groups, industries or parts of industries, labor or the various affected professions, and many, more varied segments.

Thus what has emerged is an enormously complex and confusing aggregation of special purpose programs -- some very broad in concept and some very narrow, but all categorized within federally predetermined limits -- being carried out to a major extent by the U.S. Department of Housing and Urban Development (HUD), but also to a significant extent by several other departments and agencies. Correspondingly, the substance of these programs is evaluated within the Congress by primarily one set of House and Senate committees but important elements also fall within the jurisdiction and interest of a half-dozen other sets of committees.

Furthermore, all of this Federal involvement in activities which were local in impact -- even if national in import -- has led inevitably to considerable confusion and controversy over the appropriateness of the respective roles of the various levels of government involved: Federal, State, and local. These issues, difficult enough in themselves, are made even more so by the enormous number and variety of existing local government jurisdictions.

The basic control over federally assisted housing activities has tended to stay in the hands of the Federal Government -- primarily because it had first identified and attacked the problems, and to a large extent because it has provided most of the money. Over the years, the presence and endurance of Federal control has contributed to the development of a multiplicity of programs with differing and sometimes conflicting and overlapping requirements and procedures. The balancing of roles of the various levels of government is an ever-continuing process, with no final resolution of how they should be balanced yet in sight.

The history of the development of the Federal Government's present role in housing matters and some of the complexities and other features of existing legislative

authorizations for Federal housing programs are described in broad outline by the pages that follow.

PRELIMINARY FEDERAL HOUSING EFFORTS

Since President Theodore Roosevelt appointed the first Presidential Commission to evaluate slum conditions in 1908, presidential panels have developed into a prime source of housing recommendations and policies.

The Roosevelt Commission in its report to the President recommended:

"A little government aid extended to these unfortunates (District of Columbia slum inhabitants) in the form of a loan to build them habitable dwellings would tend immensely toward their uplifting and improvement . . . All unsightly and insanitary property should be condemned and purchased by the government, improved in a uniform manner and inexpensive and healthful habitations erected for the poor, who could rent or purchase their homes on installment plans at low rates of interest."¹

However, it would be another 10 years before the Federal Government approved the Nation's first housing program. It was not until World War I that the Congress, acting on the recommendation of the Council of National Defense, approved legislation aimed at providing adequate housing for defense workers. It authorized the United States Shipping Board and Emergency Fleet Corporation to provide housing for shipyard workers through loans to subsidiaries of shipbuilding firms.

The Congress also authorized \$100 million for direct construction of housing by a newly created United States Housing Corporation. The Corporation spent some \$52 million in the production of about 6,000 dwellings and 7,000 dormitory accommodations near defense industries for families and individuals. After the war, housing under both programs was either sold or demolished, and there was no further direct Federal activity in the housing area until the 1930's.

¹U.S. Congress, Senate, Reports of the President's House Commission, 60th Cong., 2nd sess., 1909.

RESPONSE TO THE GREAT DEPRESSION

President Hoover's Conference on Home Building and Homeownership provided in December 1931, the first impetus for the basic home financing legislation that evolved during the 1930's.

In his opening statement to the Conference, President Hoover said:

"I am confident that the sentiment for homeownership is so embedded in the American heart that millions of people who dwell in tenements, apartments and rented rows of solid brick have the aspirations for wider opportunity in ownership of their houses."

Essentially, the conference was a fact-finding body that identified the weaknesses and inadequacies of housing and home financing rather than an instrument for developing specific legislative recommendations. Although the recommendations made by the conference did not directly call for increased or new Federal involvement in the national housing credit market, the fact was that the President's initiative in calling such a conference and the reverberations of its discussions had much to do with the pioneering legislation which was shortly to follow. The conference highlighted for the Nation the existing inadequacies of home construction and rehabilitation, the need for further research and distribution of information on the subject, the crucial problems of building and loan associations and other lenders arising from the Great Depression and the flaws in foreclosure, zoning, and other State and local laws. Its findings reflected the drastic impact of the Depression upon homeowners: some 50 percent of all home mortgages in the Nation were in default; foreclosures neared the astronomical rate of 1,000 per working day in late 1931 and 1932; and new mortgage lending and new home building were sharply reduced, dropping still further in the year following.

In response to this crisis, the Congress acted in broad and sweeping ways that permanently changed the nature of housing credit markets. It created three emergency and four permanent institutions that continue to this day to exercise vast influence over the housing industry. In 1932, 1933 and 1934, these agencies were established in rapid succession: the Reconstruction Finance Corporation;²

²Authorized by the Emergency Relief and Construction Act of 1932.

the Federal Home Loan Bank Board and Federal Home Loan Bank System;³ the Federal Deposit Insurance Corporation;⁴ the Home Owner's Loan Corporation;⁵ the Public Works Administration;⁶ the Federal Savings and Loan Insurance Corporation;⁷ and the Federal Housing Administrationn (FHA).⁸

The strong thrust of this Depression era legislation was "pump priming." It sought to stimulate the private sector to build housing and to help individuals to retain their homes or to acquire new housing.

There were emergency loans to faltering financial institutions through the Reconstruction Finance Corporation to pump credit into the economy and even directly to "... corporations formed wholly for the purpose of providing housing for families of low-income or for the reconstruction of slum areas"

Encouragement was given to the formation of institutions to provide long-term mortgages from the regular and long-term savings of individuals under the Federal Home Loan Bank System. The Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation provided new protections for the small depositor to dispel fears of financial collapse and renew a steady stream of deposits and savings from which credit might once again begin to flow.

Under the Home Owner's Loan Corporation program, there were emergency loans on a new, long-term self-amortizing basis to refinance defaulted and foreclosed home loans, thus seeking to end the panic of homeowners and lenders alike. The Public Works Administration initiated a program of public works to provide jobs, clear slums and construct or repair

³Authorized by the Federal Home Loan Bank Act of 1932

⁴Authorized by Banking Act of 1933

⁵Authorized by the Home Owners Loan Act of 1933

⁶Authorized by the National Industrial Recovery Act of 1933

⁷Authorized by Title IV of the National Housing Act of 1934

⁸Authorized by the National Housing Act of 1934. Since 1934, new FHA mortgage programs have been enacted as amendments to the 1934 Act and are commonly known by their section number in that Act.

low-cost housing projects. And finally, a new agency, the FHA, was created to insure the type of long-term home mortgage loans for new construction, resale and rehabilitation that had first been offered under the Home Owner's Loan Corporation for defaulted home loans.

It is difficult to comprehend what the housing credit market was like before these institutions were created. Today, Americans take for granted a private mortgage credit market offering 30-year, low-downpayment loans on homes and recently supporting the construction of over two million new housing units annually.

In the 1920's when the population was about half of today's, annual production averaged about 700,000 units per year, and the family mortgage constituted a major financial burden. Until the Federal laws of the early 1930's, the typical home mortgage was for one to five years -- and seldom for longer than 10 years. Loans for half the value of the property carried a high interest rate and had to be repaid in full or refinanced at maturity. The prime mortgage was often accompanied by second, third, and sometimes fourth mortgages, at still higher interest rates due to their lesser claim on the property.

It was the Depression-born institutions which demonstrated the soundness of the fully amortized long-term, low-monthly payment, low-downpayment mortgage. The original FHA mortgage maximums were 20-year term, 80 percent loan-to-value ratio, and \$16,000 in face amount.

There were two other Depression initiatives of enduring significance: one, to provide further means to assure an adequate and balanced flow of housing credit, the other to serve the housing needs of the poor.

In enacting the National Housing Act of 1934, the Congress sought to encourage the liquidity of mortgage credit by authorizing the formation of private secondary mortgage markets, particularly for the new, long-term mortgages it had fostered. In contrast to other investments there had been no ready market for the purchase and sale of these mortgages. Even the FHA insurance backed by the full faith and credit of the United States behind the loan had been insufficient to arouse adequate investor interest. A mortgage holder, having less opportunity to shift freely from one investment to another, did not have "liquid" assets. In 1938, the Federal National Mortgage

Association (familiarly known as "Fannie Mae") was created to fill this gap in the housing credit market. Its primary functions were to provide a conduit between idle pools of savings and borrowers in need of funds for new construction and repair, and to encourage the flow of capital across the Nation from areas of surplus to areas of short supply.

The second major Depression-born legislation was the United States Housing Act of 1937 which provided financial assistance to local public bodies for low-cost housing to be occupied by low-income families. That program took the place of the direct construction of similar housing by the Federal Government under the Public Works Administration, which had been terminated, in effect, by the Federal Court of Appeals decision of United States v. Certain Land in the City of Louisville, Jefferson County, Kentucky.⁹ That decision held in 1935 that the general welfare clause in the United States Constitution does not authorize condemnation of private property for low cost housing and slum clearance. The provisions of the National Industrial Recovery Act on eminent domain, as applied to such housing by the Public Works Administration, were declared unconstitutional. The court held that housing is not a "public use" as required for eminent domain, on the grounds that benefits of employment and aid to a limited group of low-income people did not constitute a public use.

The United States Housing Act of 1937 made permanent, on a modest scale, the goals of slum clearance and low-cost housing set forth earlier in the emergency public works program under the National Industrial Recovery Act. Demonstrating its Depression-era heritage, the 1937 Act gave as its first aim "... to alleviate present and recurring unemployment..." In addition, it was intended to "remedy" the unsafe and insanitary housing conditions and the acute shortage of decent, safe and sanitary housing for families of low-income that are "... injurious to health, safety and morals of the citizens of the Nation."

A basic feature of the new low-rent public housing program authorized by the 1937 Act was a Federal contract to pay the annual principal and interest on long-term, tax-exempt bonds, which financed construction by the local public body. With the payment of the costs of permanent

⁹78 Fed. 2nd 684, certiorari granted 269 U.S. 567, appeal dismissed 297 U.S. 726 (1935)

financing and construction thus assured and the State and local tax exemption of the property authorized by the Act, rents by the local agency could be set at low levels, since rents had to cover only operation and maintenance costs in order for the project to break even. (In recognition of the property tax exemption, the Act requires local agencies to make payments in lieu of taxes equal to 10 percent of annual shelter rents -- rents less utilities -- or such lesser amount as prescribed by State law or agreed to by the local governing body.)

Generally, the program was administered locally by semi-autonomous public bodies, authorized by State law and known as local housing authorities, rather than by cities or other general purpose government bodies. That was done because, at the time, most general governmental bodies had constitutional debt limitation problems. There was also a belief that housing authorities would provide continuity of operations during a change of administration in the city government. Because of subsequent State court decisions in the bond law field, there is no longer a strictly legal necessity for the separation of public housing activities from the rest of municipal functions.

In the 36-year history of the public housing program, it has provided only a modest part of the Nation's annual housing production, averaging about 30,000 completed units per year. However, as of December 31, 1972, the program had under contract a total of more than 1,260,000 units of which 1,055,000 were under management, thus providing approximately 1-1/2 percent of the Nation's total housing stock.

In 1937 the Federal Government also recognized rural housing needs. The Department of Agriculture was authorized under the Bankhead-Jones Farm Tenant Act to make long-term interest loans to farm tenants and sharecroppers to be used for farm purchase and repair of farm buildings. However, the Act was never considered to be a housing program as such because its major thrust was toward encouragement of ownership of adequate sized farms and of equipment. In this context housing was treated merely as an adjunct of the physical plant of the entire farm.

IMPACT OF WORLD WAR II

President Franklin D. Roosevelt, using his emergency war powers, created the National Housing Agency in 1942. The new agency centralized all Federal housing authorities under a single administrator for war needs. Through the

auspices of the National Housing Agency, nearly 853,000 units of defense and war housing were provided by direct Federal construction under the Lanham Act of 1940 and related acts of the early 1940's. Subsequently, lacking the stimulus of the war effort, the Federal Government abandoned its role of directly supplying housing; it demolished two-thirds of the wartime-constructed units and sold the remainder.

The construction of private housing for defense and war purposes was assisted by the first special purpose FHA programs, enacted in 1941 and 1942 as Sections 603 and 608, respectively. These programs provided mortgage insurance on liberal terms to builders providing housing in "critical defense areas;" they were re-enacted and made available to veterans after the war ended.

The wartime shortage of housing, due to shutdown of nearly all residential construction except in defense areas, and the low level of production in the 1930's, was compounded by the number of returning veterans in 1945. As part of a broad package of benefits in the G.I. Bill of Rights, (Servicemen's Readjustment Act of 1944), a new homeownership program was enacted for veterans. To date, it constitutes the largest program ever enacted for a single target group. All other programs for the poor, the elderly, the handicapped, minority groups, and college housing, are dwarfed by the scale of the Veterans Administration (VA) housing program.

In all, 8.7 million veterans loans have been placed, totalling close to \$100 billion. Of these, about 3.9 million loans, with a balance of \$45.5 billion, are still outstanding. Only the cumulative outstanding balance of FHA mortgages insured under its basic Section 203 single-family home mortgage insurance program of \$51.1 billion exceeds the total loans guaranteed by the VA.

POSTWAR ENACTMENT OF NATIONAL HOUSING POLICY

The Housing Act of 1949 represented the culmination of a lengthy series of companion or rival bills which successively and continuously received the attention of three Congresses.

Throughout most of the 1940's, both the Executive Branch and the Congress considered numerous proposals for programs to eliminate the slum housing in the Nation's cities. A 1941 FHA publication, A Handbook on Urban Re-development for Cities in the United States, recommended

a planning agency for each city; proposed a local government corporation with authority to acquire, hold and dispose of real property for redevelopment; and suggested the possible need for Federal financial aid. In December of the same year, a proposal conforming in more detail to the Federal urban development program as later authorized was made in an article, Urban Development and Housing, by Guy Greer and Alvin H. Hansen, published by the National Planning Association.

Legislation introduced in 1943 led to a 1945 Congressional Report, Postwar Housing, which proposed:

"The establishment, on a provisional basis, of a new form of assistance to cities in ridding themselves of unhealthful housing conditions and of restoring blighted areas to productive use by private enterprise."

Subsequently, from 1945 to 1949, Congress debated the details of new housing and slum clearance legislation. During that 4-year period, strong support for legislation came from the general public, stimulated by the severe nationwide housing shortage following the war, and from President Harry S. Truman who called for enactment of comprehensive housing legislation in several strongly worded statements. Many members of Congress, led by Senator Robert Taft of Ohio, also were prominently identified with the development and enactment of the new legislation.

The Housing Act of 1949, which was enacted with broad support from both political parties, contained the clearest statement to that time of a national commitment to housing, and reaffirmed the use of private resources, local governmental initiatives and Federal financial assistance in achieving housing goals. Section 2 of the Act states:

"The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family, thus contributing to the development

and redevelopment of communities and to the advancement of the growth, wealth and security of the Nation." (emphasis supplied)

It was a commitment to provide decent housing for all citizens and to remove slum conditions, but it was a commitment without a timetable and without adequate means for accomplishment.

Beyond the statement of policy, the Act created the Urban Redevelopment Program (Title I), which later became the urban renewal program; greatly increased the funds available for public housing (Title III); and established new programs for rural housing (Title V).

Urban redevelopment was seen as an expansion of the related programs of low-income housing and slum clearance established by the Housing Act of 1937. Basically, Title I provided Federal assistance to local public agencies for projects consisting of the assembly, clearance, site-preparation and sale or lease of land at its fair value for uses described in a redevelopment plan for project costs. The Federal grants generally could not exceed two-thirds of net project costs, and the local agency was required to furnish the remaining one-third, which could be in the form of cash, donation of land, or public facilities such as schools to support or serve the new uses of land in the project area. The Housing Act of 1949 also required that the redevelopment plan be approved by the governing body of the locality.

In Title III, the Act of 1949 authorized 135,000 new public housing units for each of the next 5 years -- a number far in excess of the previous low rent housing efforts and far in excess also of the amounts the Congress subsequently voted to fund each year as well.

Under the provisions of Title V, the Farmers Home Administration (FmHA), established by the Farmers Home Administration Act of 1946, was authorized to establish a program of grants and loans for the construction or reconstruction of farm dwellings. The rural housing program was established after a Congressional finding that the scarcity of credit resources in rural areas made the use of then existing FHA programs very difficult. The program was extended to non-farm rural housing by the Housing Act of 1961 and has been expanded considerably over its 24 year life.

REFINING AND BROADENING HOUSING LAWS FOR SPECIAL GROUPS

With the 1950's Federal housing policies became increasingly directed toward meeting the needs of special interest groups. It was a period characterized by refining the operations of the Federal Government's secondary financial market structure to eliminate the risk of fraud while at the same time liberalizing standards to permit reaching the housing needs of newly identified target groups, such as the elderly and servicemen. It was additionally an era in which the housing goals outlined in previous years were broadened to include not only the removal of slums but also the rehabilitation of existing structures to provide housing for a wider range of people. The basic approach in achieving the emerging goals was through modification of the Government's existing financial and insuring mechanisms rather than by direct outlays although some new major programs did rely on direct outlays.

PRESIDENT EISENHOWER'S ADVISORY COMMITTEE ON GOVERNMENT HOUSING POLICIES AND PROGRAMS

President Dwight D. Eisenhower's Committee on Government Housing Policies and Programs was established in 1953 to broadly review the housing and urban development programs and make recommendations for changing and eliminating programs or establishing new ones. The Eisenhower Committee met over a period of months and issued its comprehensive report in December 1953, recommending retention of some programs without change, the substantial modification of others, and the enactment of additional ones.

The most significant subjects considered by the Eisenhower Committee grew out of the urban development program authorized in 1949 which was just then getting into full operation in cities and was precipitating some serious community problems.

The Eisenhower Administration was principally concerned with accommodating public objections to the large expenditures for "bulldozing" slum areas, which often remained vacant for long periods because of problems in getting housing or other redevelopment underway. In response to that problem, the Eisenhower Committee recommended a re-direction and broadening of the scope of urban redevelopment projects to include the rehabilitation of existing structures. This change was enacted in the Housing Act of 1954 and eliminated the need to "bulldoze" areas where rehabilitation work was being done.

In this connection the name of the entire program was changed to "Urban Renewal." Urban rehabilitation efforts were not as extensive as contemplated because of problems related to the sponsorship and financing of housing rehabilitation efforts. Nevertheless, there was general application of urban renewal powers in rehabilitation areas which often involved code enforcement or other municipal efforts and expenditures for improvement of streets, public utilities, parks, and other facilities. Also, the 1954 Act required a community to have a "workable program" for solving its overall development problems as a condition for receiving urban renewal and related Federal aid.

The 1954 Act addressed another major problem under the 1949 Housing Act -- the difficulty of initiating housing construction on the cleared site. A redevelopment project site either had to be "predominately residential" before clearance, or be redeveloped for predominately residential purposes after clearance. The then existing FHA insurance programs were wholly inadequate to attract credit and sponsors.

Accordingly, the Congress included in the 1954 Act a new mortgage insurance program, known as Section 220, to generate housing credit and production in urban renewal areas. Traditional insurance terms were liberalized in several respects and purchase of the mortgages by the Federal National Mortgage Association was authorized. The program has been one of the major special purpose programs of FHA. Criticism of it in later years stemmed from the fact that it produced housing for high-income families and not for those displaced from the area. However, it never was intended for low-income or displaced families as such, but to provide housing needed in the community and housing which would add to the city's tax base.

By 1953, experience had begun to show the magnitude of the urban renewal problems resulting from the displacement of families from project sites to be cleared. This problem became the chief basis for lack of project approvals by local governing bodies, in those cases when disapproval occurred. The lack of adequate housing for the displaced was critical, and there was growing concern for the plight of those affected who were generally minority families.

Accordingly, the Eisenhower Committee recommended a special liberalized mortgage insurance program for housing displaced families, which was enacted in the 1954

Act as Section 221. This new authority required that the housing involved be "programmed" for each area on the basis of the number and income of families displaced by Federal, State or local governmental action, and that they receive priority of opportunity to purchase or rent the completed dwellings.

This mortgage insurance program to assist displaced families marked the beginning of concern for adequate and prompt relocation of those displaced by slum clearance and other governmental actions.

Another important recommendation by the Eisenhower Committee, which was enacted by the Congress in the 1954 Act, was a complete reform of the Government's secondary market structure, both as to the role of the Federal Government and that of the private financial community. It conformed with a basic element of the Eisenhower Committee's approach, which involved an effort to design a secondary market facility that would derive capital from participating lending institutions and would eventually finance itself in the private capital markets, rather than relying upon the Federal Treasury as had been done in the past.

The Federal National Mortgage Association statutory authority was rewritten completely in a new Federal National Mortgage Charter Act, which was part of the 1954 Act. It divided Federal National Mortgage Association operations into three parts: "secondary market operations," "special assistance functions," and "management and liquidation functions." The chief result of this division was to isolate the special assistance functions (which need government financial aid) from other Federal National Mortgage Association operations. The special assistance functions continued primarily for special FHA mortgage insurance or the VA guaranty loan program requiring the Government purchase of mortgages.

The 1954 Act contained other important provisions, including consumer protection measures specifically designed to avoid further frauds and abuses such as those revealed in 1953 and which were known at the time as "the FHA scandal." These frauds occurred under the Title I Repairs and Rehabilitation Loan Insurance program and the Section 608 War and Veterans Housing program of the Housing Act of 1949.

Under the Title I program, FHA insures approved financial institutions against losses they might sustain as a result of certain loans for financing repairs and improvements to real property. These loans are not individually

insured or processed; FHA insures against losses up to 10 percent of an individual lending institution's total loans. As the loans are not processed individually, the FHA relies on the lending institution for their validity and soundness. Before the 1954 Act, the program was abused by fraudulent repair salesmen who generated negotiable paper on the basis of shoddy work or inadequate worthless material. The 1954 Act attempted to correct this situation by requiring, among other items, a real co-insurance feature so that not more than 90 percent of each individual loan would be covered by insurance (in addition to earlier limitations).

The frauds under the Section 608 War and Veterans Housing program consisted primarily of "mortgaging out" on the basis of greatly excessive estimated costs which determined the mortgage amount. The sponsor simply kept the money under the mortgage to the extent it was not needed for the development. This was prevented in future programs by the "cost certification" requirement which obligates the sponsor to certify costs after development, and requires FHA to limit the mortgage amount accordingly.

The 1954 Housing Act, in hindsight, was a watershed for subsequent housing programs to meet the needs of specifically designated groups that followed in increasing number throughout the remainder of the 1950's and into the 1960's.

SEPARATE FHA MORTGAGE INSURANCE PROGRAM FOR GROUPS HAVING SPECIAL NEEDS

The growth of the scope of FHA mortgage insurance programs through the years has resulted primarily from the gradual liberalization of mortgage terms under FHA's regular insurance operations and the enactment of special insurance programs particularly during the 1950's to meet the emerging housing needs of specific groups or in response to the new forms of cooperative and condominium ownership. It was in this way that the overall character of FHA was changed from an agency concerned almost entirely with increasing the supply of adequate housing to an agency widely concerned with serving special public purposes in the housing field.

This broadening was initiated by the 1954 Housing Act which attempted to generate credit for urban renewal projects under Section 220 and to provide for families displaced by these projects under Section 221, as well as by the creation of the new Federal National Mortgage

Charter Act in 1954 which established the first special assistance functions to be carried out by the Federal National Mortgage Association.

Outside criticism of the special purpose programs developed on the grounds that they diverted FHA efforts from volume production and resulted in high-risk insurance. This was based on the liberalized underwriting standards of the special purpose programs, and the FHA time and effort invested in encouraging operations under them when they presented obstacles to sponsors because of financing problems or problems inherent in servicing the special groups to be benefited.

Generally, each of these new special programs was established as an almost independent operation with its own statutory provisions and insurance fund, in order to prevent the original FHA mortgage insurance fund supporting FHA's basic programs enacted in 1934 for Section 203 single-family home mortgage insurance and Section 207 multifamily apartment mortgage insurance from being adversely affected by the liberal underwriting terms of each new program. The essence of each new program was a liberalization of mortgage terms beyond those in effect at the time under the regular insurance programs. Usually, mortgage terms were liberalized in three ways: the "economic soundness" test for the proposed construction was replaced with an "acceptable risk" test; the maximum insurable mortgage loan was based on "replacement cost" rather than on the more conservative estimate of long-range "value;" the maximum percentage or ratio of loan to "replacement cost" was made higher than the earlier percentage of loan to value (and, in some cases, the maximum term of the mortgage was lengthened, thereby permitting lower monthly payments).

A continuation of the liberalizing approach initiated in the 1954 Housing Act by Sections 220 and 221 came with the enactment of Section 231 in 1959 which granted generous insurance terms for housing of the elderly. This program was approved in an era of growing recognition of the problems of the elderly by Congress.

Separate mortgage insurance programs were enacted to give special insurance advantages to several designated groups in special areas.¹⁰

¹⁰World War II defense and veterans, 1941; Korean War defense areas, 1951; urban renewal areas, 1954; displaced families, 1954; non-World War II servicemen, 1954; and military rental housing, 1955.

In 1961, further focusing on special interest groups, the Congress enacted the Section 234 program which did not actually involve liberalized insurance terms but was an adaptation of regular mortgage insurance to conform to the special characteristics of condominium ownership and obligations.

Other special non-housing or "fringe" FHA mortgage insurance programs were enacted to assist the construction or purchase of nursing homes, hospitals, group practice facilities, recreational homes, trailer courts, mobile homes, and housing in Alaska.

In addition to special mortgage insurance programs, the direct loan program to assist the construction of college dormitories for students and faculties was enacted in 1950 to meet the rapidly increasing enrollments starting in the post-World War II era and to assist returning veterans.

The trend established under the 1954 Act expanded from liberalized lower cost insurance to indirect subsidy without insurance with enactment of Section 202 in the 1959 Housing Act. Under this new and separate program direct loans were to be made through the device of government subsidized low interest rates to provide housing for the elderly. Under the program a loan could cover 98 percent of development cost and have an interest rate as low as 3 percent. (The Congress set the low rate in 1965.)

THE SUBSIDY INITIATIVES OF THE 1960'S

Housing legislation in the 1960's took an evolutionary approach toward meeting the Nation's housing needs. New emphasis was placed on providing housing to special groups such as the poor. Instead of relying upon revising the financial mechanisms, as in the 1950's, the Government embarked on direct and indirect subsidies. It also added new emphasis to the goal spelled out in the 1949 Housing Act of providing a "decent home and a suitable living environment" for all Americans.

The indirect subsidy initiated through the Section 202 program of the 1959 Housing Act providing low cost loans to developers of private housing for the elderly can be said to be the forerunner of later subsidy programs.

The principal feature of the Housing Act of 1961 was the subsidized, below market interest rate mortgage insurance program to assist rental housing for moderate income

families, known as Section 221(d)(3). Not only was the new program an interest subsidy program, it also was a direct loan program. Since private lenders would not make mortgage loans at below-market interest rates, the funds were provided through the purchase of the originator's mortgage by the Federal National Mortgage Association under its special assistance functions. The chief beneficiaries of this program were those families whose incomes were above public housing limits set by local housing authorities but were below the amounts necessary to meet rental requirements in decent, new unsubsidized private housing.¹¹

¹¹However, it should be noted that the new trend toward subsidies for private housing did not replace the earlier trend toward liberalized, albeit unsubsidized, mortgage programs. The Housing Act of 1961 amended the Section 221 mortgage insurance program, which to that time, had been directed to only those families displaced by Governmental action such as urban renewal, to provide more liberal terms and to broaden the program to apply to low- and moderate-income families generally. In addition to authorizing the Section 221(d)(3) Below Market Interest Rate Program, the Act authorized or continued the following programs:

- A. Section 221(d)(2): provides mortgage insurance for the acquisition, construction or rehabilitation of one- to four-family homes by low- and moderate-income families. Eligible owner/occupant mortgagor are enabled under this program to obtain financing with a downpayment as low as 3 percent of acquisition cost; those mortgagors who in addition have been displaced may arrange financing with a downpayment as low as \$200 on a single family property. The mortgagor is permitted to reduce further his cash downpayment requirement by being allowed the maximum feasible opportunity to contribute the value of his labor as equity in the property.
- B. Section 221(d)(3) Market Interest Rate Program: designed to help finance construction or rehabilitation of projects by public agencies, investor-sponsors, nonprofit groups and limited dividend corporations; provides rental or cooperative housing within a price range appropriate to the resources of displacees and other low- and moderate-income households. The cooperative program, because of its high loan-to-value ratio (100 percent of replacement costs for nonprofit sponsors, 90 percent

for limited dividend sponsors) has been a vehicle for providing homeownership opportunities for families immediately above the subsidy levels. The rental program, combined with the rent supplement program, authorized by the 1965 Housing Act, enables low-income families to afford privately-owned, financed and operated rental accommodations.

- C. Section 221(d)(4): encourages the construction or rehabilitation of multifamily rental units for moderate income families through profit incentives to sponsors, tax incentives and use of replacement cost in determining the value on which the insured amount is based. Statutory provisions for Sections 221(d)(3) and 221(d)(4) are the same except for the type of sponsorship and the related profit restriction. Because of the obvious benefit provided by the profit incentive, combined with other incentives mentioned above, Section 221(d)(4) is the primary program for the development of unsubsidized rental housing for families of moderate income.

After the trends of the 1960's toward subsidies for private housing and liberalized programs, HUD mortgage insurance programs continued to proliferate, as illustrated by Chart 1.

The 1961 Act further expanded the subsidy concept by authorizing payments of up to \$120 on housing units occupied by the elderly poor in public housing projects. The subsidy was based on the belief that the elderly's housing needs could not otherwise be met without endangering the solvency of the project, despite the Federal Government's annual contribution.

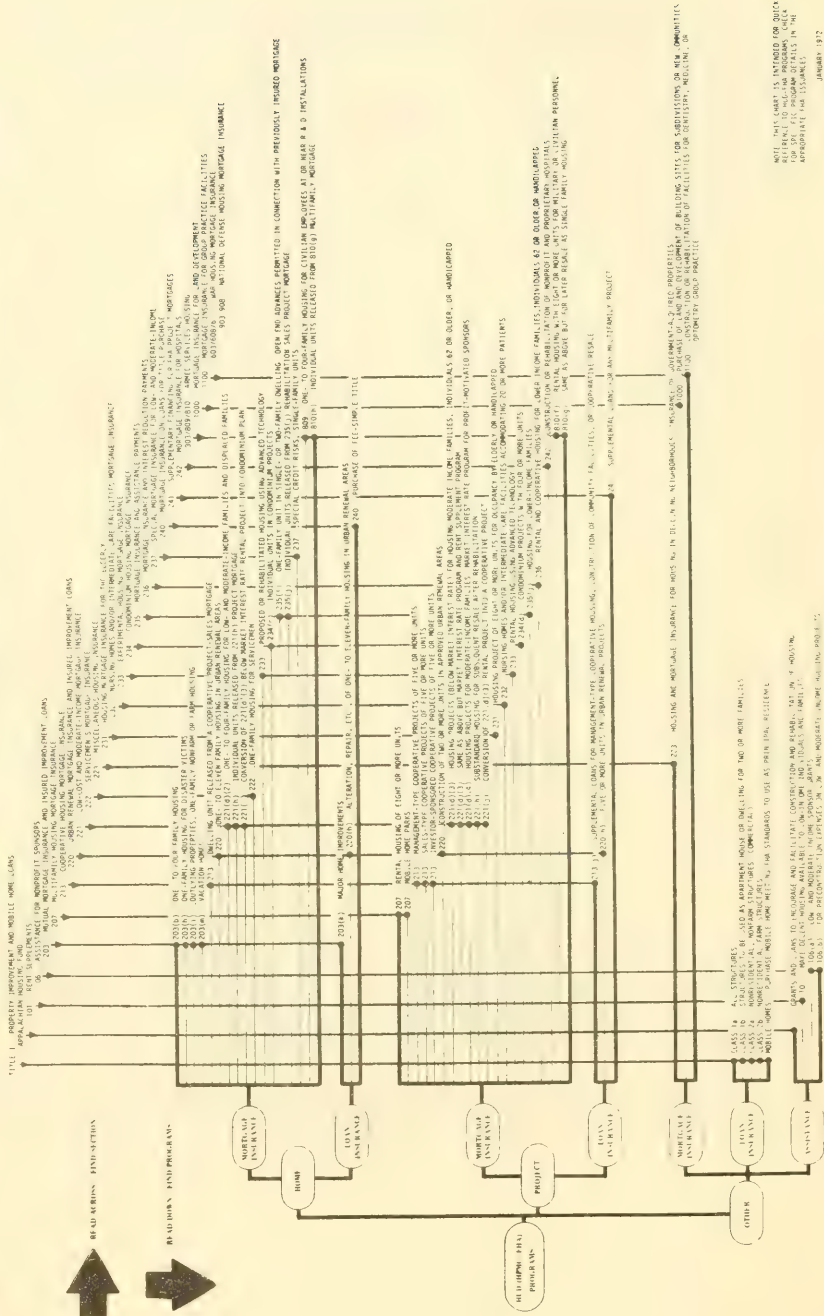
The subsidy was the first ever given to finance the operating costs of housing projects, along with capital costs.

The Housing Act of 1964 extended the subsidy treatment given for housing the elderly to families displaced by urban renewal projects. In 1968, the subsidy was made available for large families with unusually low incomes who were living in housing projects and could not afford to remain without the additional subsidy.

In the Housing Act of 1964, the Urban Renewal statute, Section 312, was amended to authorize a new program of 20-year, 3 percent loans to property owners or tenants

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT MORTGAGE INSURANCE PROGRAM

CHART 1



NOTE: THIS CHART IS INTENDED FOR QUICK REFERENCE TO HCL-THA PROGRAMS. CHECK FOR SPECIFIC PROGRAM DETAILS IN THE APPROPRIATE HCL ISSUES.

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in urban renewal areas to finance rehabilitation required to make the property conform to the local housing code or to carry out the objectives of the urban renewal plan.

Two additional subsidy programs were enacted by the Housing Act of 1965 to provide housing for families at the income level of those eligible for regular public housing through the utilization of privately-owned housing. These programs also served to avoid a growing stigma communities had begun to attach to the concentrations of public housing. Both programs permitted broader dispersal of the very poor among varied income groups.

One of these programs was the rent supplement program under which Federal payments are made to meet a portion of the rent of certain low-income families¹² in privately owned housing built with FHA mortgage insurance assistance. Each tenant must pay one-fourth of his income for rent. The program was originally proposed for middle income families but the Congress quickly altered it to apply only to low-income families.

The other new subsidy program enacted in 1965 was the Section 23 leasing operation which became one of the major public housing programs. Under this program, local housing authorities are authorized to lease units in privately-owned existing structures and make them available to low-income families eligible for regular public housing. The usual public housing assistance is made available by HUD so that the local authority can pay the economic rent to the owner without charging the tenant more than the usual public housing rental.

In 1967, the Department of Housing and Urban Development initiated, as an administrative procedure, the "Turnkey method." Under this variation of the regular public housing program, a private developer enters into a contract with a local housing authority to sell the project upon completion to the local authority. The introduction of private profit-making developers into

¹²To qualify, a tenant is subject to public housing income limits and asset limitations and must be one of the following: displaced by governmental action; 62 years of age or older; handicapped; living in substandard housing; or living in housing damaged by natural disaster.

the production process reduced development costs and also increased program activity. A total of 214,096 units were under annual contribution contracts as of December 31, 1972, while 143,726 units were under management.

The Housing Act of 1965 also authorized the Section 115 program, providing for the use of urban renewal capital grant funds for limited grants to low-income owners of homes in urban renewal areas to pay for necessary repairs and rehabilitation.

A very limited program of homeownership subsidies was introduced in 1966 with the enactment of Section 221(h). It authorized 3 percent mortgage loans (as under the 221(d)(3) Below Market Interest Rate Program) to nonprofit sponsors who would buy and rehabilitate at least four homes, for subsequent resale to low-income home purchasers. The low-income home purchaser would also receive a 3 percent mortgage (via the Federal National Mortgage Association special assistance program).

THE CREATION OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

The Department of Housing and Urban Development Act, passed September 9, 1965, created HUD, although it was not actually organized until February 1966.

The Act was a milestone in housing legislation. Most importantly, it raised the functions of the Housing and Home Finance Agency to cabinet level and simplified the administration of all its functions by consolidating most statutory authority in the Secretary of the new department. It did not, however, consolidate housing and urban development functions existing in other parts of the Federal Government. The Secretary was given power to organize the functions of the Department as he deemed appropriate; however, the Act prescribed that there

"...shall be in the Department a Federal Housing Commissioner, who shall be one of the Assistant Secretaries, who shall head a Federal Housing Administration within the Department, who shall have such duties and powers as may be prescribed by the Secretary ..."

In creating HUD, the Congress characterized its action and intentions as follows:

"The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of our people require, as a matter of national purpose, sound development of the Nation's communities and metropolitan areas in which the vast majority of its people live and work."

"To carry out such purpose, and in recognition of the increasing importance of housing and urban development in our national life, the Congress finds that establishment of an executive department is desirable to achieve the best administration of the principal programs of the Federal Government which provide assistance for housing and for the development of the Nation's Communities; to assist the President in achieving maximum coordination of the various Federal activities which have a major effect upon urban community, suburban, or metropolitan development; to encourage the solution of problems of housing; urban development, and mass transportation through State, county, town, village, or other local and private action, including promotion of interstate, regional, and metropolitan cooperation; to encourage the maximum contributions that may be made by vigorous private homebuilding and mortgage lending industries to housing, urban development, and the national economy; and to provide for full and appropriate consideration, at the national level, of the needs and interests of the Nation's Communities and of the people who live and work in them."

DOUGLAS AND KAISER COMMISSIONS

The urban disturbances of the late 1960's led to the creation of two Presidential Commissions that were to have a profound impact upon the redirection and expansion of Federal housing policies. In 1967, President Lyndon B. Johnson directed the creation of the National Commission on Urban Problems, known as the Douglas Commission after its chairman, Paul H. Douglas, Senator from Illinois from 1948-1966, with a mandate to recommend "solutions, particularly those ways in which the efforts of the Federal Government, private industry, and local communities can be marshalled to increase the supply of low-cost decent housing." The Douglas Commission's prime recommendation was

to direct the nation's housing effort to the poor, a group which the Commission found had been neglected in the nation's housing endeavors to that time.

Also in 1967 the President's Committee on Urban Housing, known as the Kaiser Commission after its industrialist chairman, Edgar F. Kaiser, was appointed with a charge to "find a way to harness the productive power of America ... to the most pressing unfulfilled need of our society -- that need is to provide the basic necessities of a decent home and healthy surroundings for every American Family now imprisoned in the squalor of the slums." Among its many recommendations, the Committee called for the establishment of a 10-year goal of 26 million new and rehabilitated housing units, including at least six million for lower-income families. That recommendation was to shape future Congressional action and Federal policy.

NATIONAL HOUSING GOALS

The Johnson Administration recommended, and the Congress enacted, in the Housing and Urban Development Act of 1968, the housing goal proposed by the Kaiser Commission. That Act includes the following:

"Reaffirmation of Goal"

"Sec. 1601. The Congress finds that the supply of the Nation's housing is not increasing rapidly enough to meet the national housing goal, established in the Housing Act of 1949, of the 'realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family.' The Congress reaffirms this national housing goal and determines that it can be substantially achieved within the next decade by the construction or rehabilitation of twenty-six million housing units, six million of these for low- and moderate-income families."

In that provision, the Congress declared for the first time a national housing goal in terms of housing units to be produced, and established a time frame for production.

The production thrust of the goal was made clearer by specific directions in the Act that the President submit a report to the Congress setting forth a 10-year plan for meeting the goal and an annual report thereafter on the progress being made in meeting the objectives of

the plan. Each annual report must also analyze problems and factors involved in production and make recommendations with respect to any additional legislation or administrative action necessary or desirable to meet the objectives of the plan.

The lesser emphasis on conservation and rehabilitation in connection with the 1968 enactment was reflected in the estimate by HUD Secretary Robert C. Weaver¹³ that only two million of the 26 million units to be produced would be provided by rehabilitation assisted with public subsidy. Though not large, this projection was apparently optimistic and clearly exceeded past performance in rehabilitation activity. Another two million units were projected for rehabilitation by privately financed efforts, but these were not identified as part of the 26 million production program.

The statutory language concerning the 1968 housing goal suggests the production emphasis intended. The affirmation of "a decent home and a suitable living environment for every American family" was language often used through the years in connection with production objectives and bears a connotation of home construction. The placing of the goal in the context of the "Declaration of National Housing Policy" in the Housing Act of 1949 lends support to the emphasis on production. That declaration is replete with references to "production," "the housing industry," "economy of maximum employment," "residential construction," and "stabilization of the housing industry at a high annual volume of residential construction." No mention was made then of conservation, existing housing supply, or rehabilitation.

The most significant expansion of the subsidy concept was contained in the Housing and Urban Development Act of 1968 which adopted the principle of subsidizing interest rates, thus resulting in a rapid escalation of all appropriations for housing subsidies.

One of these programs was the Section 235 homeownership assistance program which originated in a proposal drafted by the Senate Committee on Banking and Currency

¹³U.S. Congress, Senate Committee on Banking and Currency. Housing and Urban Development Act of 1968. Hearings before Subcommittee on Housing and Urban Affairs. 90th Cong., 2nd sess., 1968.

in 1967. The Johnson Administration opposed these initial proposals; subsequently, the Committee proceeded to develop legislation with the assistance of HUD officials. However, no legislation was enacted that year. The following year, HUD proposed and the Congress enacted legislation similar to that jointly developed. As enacted, Section 235 established a homeownership program providing special mortgage insurance and cash payments to help low- and moderate-income home purchasers meet mortgage payments by subsidizing debt service costs in excess of an amortization at one percent interest. Under this program, an eligible buyer¹⁴ may purchase a private home with an FHA-insured mortgage, bearing the prevailing rate of interest, and the Federal Government makes a monthly assistance payment to the lender on his behalf. Provided the purchaser is applying at least 20 percent of his monthly income to the mortgage payments, he could pay each month as much as the same amount he would pay if the mortgage loan provided for only 1 percent interest. The Federal Government pays the rest.

Another significant addition to subsidy programs was the Section 236 multifamily rental housing program also enacted in the 1968 Act. This program provides a subsidy formula similar to that under Section 235, although the mechanics of the Section 236 subsidy payment are geared to rental housing.¹⁵

An accompanying provision of the 1968 Act contained a subsidy feature, Section 238, which established a special risk pool for which appropriations were authorized. This fund was authorized to be used for carrying out insurance obligations under the subsidized and certain other mortgage insurance programs. They included a new Section 223(e)

¹⁴To qualify for benefits of this program, a homeowner must be the head of a family, a handicapped person, or a single person 62 years or older; usually income cannot be in excess of 135 percent of local limits for public housing; 20 percent of income must be paid toward monthly payments.

¹⁵In that case, a monthly housing assistance payment is made by the Federal Government to the mortgagee on behalf of the mortgagor. Qualifying requirements are similar to those of the Section 235 program; however, the tenant must pay 25 percent of his income toward monthly rental. In addition, the tax shelter used to induce participation of limited-dividend sponsors in the Section 236 program reduces Federal tax revenues, thus imposing further budgetary costs. This tax treatment of Section 236 sponsors is further discussed in Chapters 2 and 4.

which authorized insurance in "older, declining urban areas," where not all of the usual mortgage insurance requirements could be met.

The Sections 235 and 236 programs are similar to the subsidized rural housing program authorized by Title V of the Housing Act of 1949 and administered by the FmHA. The Section 502 homeownership program provides loans at a set interest rate (currently 7-1/4 percent) to qualified low- and moderate-income persons in rural areas for the purchase of single-family homes; interest subsidies may be provided to eligible low-income purchasers to reduce the effective interest rate to as low as one percent. Section 515 authorized a corresponding program for multifamily rental; Section 521 authorizes a subsidized version of the Section 515 program that can reduce to as low as one percent the effective interest rate on loans made to nonprofit organizations and limited-profit corporations.

PARTITION OF FEDERAL NATIONAL MORTGAGE ASSOCIATION

In 1968, the Administration concluded and Congress agreed that the time had come to move forward with the conversion of the secondary market functions from a mixed-ownership Federal corporate activity into a privately owned and financed corporation, without waiting for the retirement of the Treasury held stock, as had been contemplated by the Federal National Mortgage Association Charter Act. This decision appears to have stemmed mainly from budgetary considerations, although it was also believed that the secondary market function would flourish better in an environment more intimately related to the private market. As a result, the Housing and Urban Development Act of 1968 partitioned the Federal National Mortgage Association, as it then existed, changing it into two new corporations. One, was a Federally chartered private corporation which, after a brief transition period, was to be privately owned, operated and financed. This corporation was to retain its name -- Federal National Mortgage Association. The second, a new wholly owned Federal corporation to be known as the Government National Mortgage Association, was to assume the functions of the former Federal National Mortgage Association with respect to special assistance and the management and liquidating operations.

In the conversion, all Treasury-held preferred stock was retired. The new Federal National Mortgage Association passed into the full ownership of its common stockholders and in due course, the undistributed earnings

and earned surplus of the predecessor corporation were distributed. The Federal National Mortgage Association remains subject to regulation by HUD.

An administrative procedure called "Tandem Plan" was developed under the Federal National Mortgage Association partition. Under this procedure the Government National Mortgage Association issues a commitment to purchase a mortgage qualifying for special assistance at a predetermined price which is more favorable than that available in the market (special assistance being unnecessary otherwise). This commitment is transferred to the Federal National Mortgage Association; when the mortgage is ready for delivery, the Government National Mortgage Association pays the Federal National Mortgage Association the difference between the committed price and the price which the Federal National Mortgage Association would have paid in its regular market purchase program. Thus the immediate budget expenditure is reduced from the full amount of the purchase commitment to this difference, usually a few percentage points of the full amount. In this manner, by paying above-market prices and selling at market prices, the Government National Mortgage Association provides indirect subsidies to borrowers and lenders. (The Tandem Plan is discussed more fully in Chapter 3.)

MODIFICATION OF LOW-RENT PUBLIC HOUSING PROGRAM

An important change in the low-rent public housing program was made by Section 213(a) of the Housing and Urban Development Act of 1969, known as the Brooke Amendment. The Amendment limited rents charged by local housing authorities to 25 percent of the tenant's income. Subsequently, the Congress authorized Federal public housing subsidies for operating expenses, where necessary, to assure the low-rent character of the public housing project. (The Brooke Amendment is further discussed in Chapter 5.)

AID TO DISPLACED PERSONS

Subsidies for the relocation of displaced families in connection with all Federal programs was placed on a uniform basis by legislation which was debated during much of the 1960's but finally enacted as the Uniform Relocation Assistance and Real Property Acquisitions Policies Act of 1970. This legislation adopted most of the relocation provisions already in effect under HUD programs and gave both owners and tenants who were displaced the right to substantial payments under Federal

or federally assisted development programs. The Act also provides:

"no person shall be required to move from his dwelling on or after the effective date of this title, on account of any Federal project, unless the Federal agency head is satisfied that replacement housing is available to such person."

MODEL CITIES

During the 1960's, support developed for a new and broader approach the housing undersupply and other problems of urban areas. A program which became known as "Model Cities" was authorized as the principal provision of the Demonstration Cities and Metropolitan Development Act of 1966. It was based on a Congressional finding and declaration that:

"... Improving the quality of urban life is the most critical domestic problem facing the United States. The persistence of widespread urban slums and blights, the concentration of persons of low-income in older urban areas, and the unmet-needs for additional housing and community facilities and services arising from rapid expansion of our urban population have resulted in a marked deterioration in the quality of the environment and the lives of large numbers of our people while the Nation as a whole prospers ..."

Under the 1966 Act, the Federal Government was authorized to make grants and provide technical assistance to city demonstration agencies to enable the agencies to plan, develop and conduct programs to improve their physical environment, increase their supply of housing for low- and moderate-income people and to provide educational and social services vital to health and welfare.

That enactment was significant in giving cities the broadest discretion in developing proposed programs, subject only to general criteria prescribed in the statute. Discretion remained in HUD, however, to select and fund those undertakings it considered best for demonstrating to other cities the potential benefits of such initiatives.

NEW COMMUNITIES

In the early 1960's there was increasing interest in the development of whole new communities as one of the means of adjusting to the Nation's increasing population and helping to meet some of the problems of urban congestion. As with other indirect programs related to housing, the New Communities Program contained significant housing components similar to those of earlier urban renewal programs. The Housing and Home Finance Agency proposed a new mortgage insurance program for land development needed by new communities, but the Congress considered it too ambitious and enacted a truncated program of "land development."

The 1965 new communities proposal was enacted, however, in the Demonstration Cities and Metropolitan Development Act of 1966. To be eligible for mortgage insurance, a proposed new community had to be of such size and scope as to make a substantial contribution to economic growth of the area. This contribution was to be in the form of economies in providing improved housing sites, adequate housing for those employed in that area, maximum accessibility to industrial and other employment centers and to commercial, recreational, and maximum accessibility to any major central city in the area. The development had to be approved by the local government body.

Recognizing that mortgage insurance alone was inadequate to stimulate an adequate volume of credit for new community development, HUD recommended in 1968 an entirely new additional assistance program based on the Federal guarantee of bonds and other obligations issued by the private developer of the new community. This meant that the Federal Government would guarantee with the full faith and credit of the United States the payment of principal and interest on the obligations of the private developer, if sold to investors or at public sale as approved by HUD after it had approved all other prerequisites with respect to the development. That program, which included certain supplemental grants for public utilities and other facilities, was enacted as Title IV of the Housing and Urban Development Act of 1968.

The guarantee program was reenacted with broader scope and further supplemental financial aids in Title VII of the Housing and Urban Development Act of 1970. The major functions in the program were placed under a "New Community Development Corporation" in HUD with a

five-man board of directors, including the Secretary of HUD as the chairman; a General Manager appointed by the President and three persons appointed by the Secretary. Under the 1970 Act, the new communities development project has to meet the same standards as under the earlier program, including requirements concerning planning and a substantial provision of housing for low- and moderate-income persons. Development must also assist the local home building industry and encourage its broad participation, particularly by the small builders.

The changes made by the 1970 Act were set in the context of an extensive legislative statement on national urban growth policy. That statement established standards for the development of such a policy and required the President to submit a report on urban growth every two years beginning in 1972, giving prescribed information on urban growth and recommending any legislation considered desirable.

FEDERAL HOUSING LAWS: CONFLICTS, DUPLICATION AND CONFUSION

There is no need for great complexity in the Federal housing laws. Mortgage insurance is a relatively simple and clear-cut concept, requiring no more than two programs, apart from subsidy operations: one for home mortgages and one for mortgages on multifamily structures, with adequate authority in the agency to provide for varying conditions and circumstances. Indeed, the original National Housing Act of 1934 was just that.

Instead, our Nation's housing laws today, after almost 40 years, are a "hodgepodge" of accumulated authorizations for some 46 unsubsidized programs and some 20 which are subsidized, including those administered by the VA and FmHA. They contain internal inconsistencies, numerous duplications, cross purposes, and overlaps as well as outright conflicts and gimmickry. In some cases, the objectives themselves are open to serious question.

The complicated maze of HUD program laws, filling hundreds of pages in the statute books, are properly recognized as replete with inconsistencies, conflicts and obsolete provisions and without overall design or coordinated structure. All this is magnified in the red tape flowing from implementing regulations.

Testimony given in Congress by the Executive Branch has emphasized the number and complexity of these existing authorities, as well as the frustration, cost, and

red tape resulting from this program hodgepodge. It seriously thwarts good administration; confuses even the experts; discourages participation by builders, lenders and sponsors; confuses consumers; and hinders Congressional oversight. In one of several statements to that effect, former HUD Secretary George W. Romney said to the Senate Subcommittee on Housing and Urban Affairs:¹⁶

"To function properly, our housing programs must bring together private builders, private lenders, private housing sponsors, public agencies and private purchasers. At present the number and complexity of our existing statutory authorities act as a deterrent to the effective participation of these groups in our housing programs. Even the most sophisticated and experienced builders, lenders and sponsors find it frustrating and costly to accommodate their operations to the red tape and delay occasioned by the maze of our confusing authorizations and the regulations, circulars, forms and processing procedures that have grown out of them.

"The man most successful and at ease in the present statutory framework of our housing programs is the packager, knowledgeable in the intricacies of our forms and procedures, who can put together an attractive application and milk the most in subsidy out of the Federal programs by combining the different forms of assistance available under our several statutory authorities. Too often the most efficient producers of housing refuse to participate in our programs because they are unwilling to deal with the intricacies of our processing and program requirements."

Romney's complaint about the Federal Government's housing programs has been voiced on frequent occasions by leading members of the Senate and House banking committees which have congressional jurisdiction over housing legislation. In fact, there has always been recognition that serious problems have resulted from the duplicative and conflicting nature of the numerous housing programs. As

¹⁶U.S. Congress, Senate Committee on Banking and Currency. Housing and Urban Development Legislation of 1970. Hearings before Subcommittee on Housing and Urban Affairs. 91st Cong., 2nd sess., 1970.

early as the 1940's, significant recommendations were made to have the entire National Housing Act of 1934 rewritten. In 1970 a HUD legislative proposal with this objective was submitted to the Congress and has received considerable attention from legislative leaders. However, comprehensive legislation of this nature has not been enacted.

WHY DID THE HOUSING LAWS DEVELOP AS THEY DID?

Perhaps the major reason why the housing laws have developed as they did has been the complexity and multiplicity of housing program objectives -- economic growth, community growth, assisting the poor, furthering civil rights, and so on, all added one on top of another to each individual housing program. While reflecting the complexity of the problems involved, in many instances those multiple programmatic goals have been conflicting ones.

Another reason has been the sheer mechanics of the way the Federal Government has adopted housing policies. Until 1970, the Congress has enacted an omnibus housing bill almost every year since the conclusion of World War II. An "omnibus" bill covers many independent items of legislation over a broad subject and reflects the accumulation of proposals in the Executive Branch and Congressional committees over a period of a year or more.

Normally, the Congressional committees responsible for housing legislation have not acted on housing bills referred to them in the interim years between enactment of omnibus legislation. The years of omnibus housing bills covered the period of increasing Federal involvement in housing and other social and economic matters. These years also covered frequent periods of substantial inflation, which upset the validity of numerous dollar ceilings in the housing statutes, thus requiring extensive amendments. The enacted housing bills were usually a combination of Executive Branch recommendations, redefined by the Congress to reflect its own interests and notions as well as the pleadings of special interest groups. Typically, each omnibus housing bill contained as riders various agency proposals and committee recommendations that could not have been enacted standing alone as separate pieces of legislation. To obtain the support, or at least remove the opposition, of organizations or individuals in Congress, a variety of amendments were added -- such as an amendment favored by a national interest group or special aid for a project in the district of a particular Congressman. With this "something for everybody" approach, critics

often referred to an enacted housing bill as a Christmas tree bill bearing gifts for all.

Generally, the agency's legislative proposal to the Congress were not based on a study or reevaluation of the relevant policies and legislative authorities. Until recently there was not even a continuing long-range study looking toward the next year's legislative program. Typically, each year was characterized by a belated effort by the agency to meet a deadline for presenting to the Bureau of the Budget the legislative recommendations for the coming year. Sometimes new approaches of possible merit were discarded simply because of the lack of time needed for study.

The problems were further compounded by divided responsibility for policy development within the Executive Branch. For example, the earliest Federal programs designed to generate mortgage credit for housing were placed in separate government agencies. It naturally developed that the Executive Branch recommendations for such programs came primarily from the agency involved, which was deemed to know best its own needs, or how it would be affected by a given proposal. Accordingly, the recommendations were fragmented and narrow.

This practice still continues to the extent that separate housing credit programs are developed simultaneously but independently by the VA, the Federal Home Loan Bank Board and the FmHA, as well as by HUD. Other less extensive housing activities are carried on by the Department of Defense, the Interior Department (Bureau of Indian Affairs), the Atomic Energy Commission and others.

At the same time, there is some overlap of Congressional committee jurisdiction over housing programs between the banking and the veteran's committees.

In more recent years, the statutory complications have been multiplied by the separate authorizations for additional subsidy operations under several different types of major programs: Section 202 direct loans at below market interest rates; Section 221(d)(3) mortgage insurance at below market interest rates supported by the Federal National Mortgage Association purchases; rent supplements; and the subsidized interest rates for home purchasers and rental housing sponsors under Sections 235, 236, 502 and 521.

Also, it must be recognized that in formulating proposed housing legislation there are conflicting major policy goals with respect to housing itself, or with respect to housing and other major Government objectives. These often account for compromises and gaps in meeting desirable and consistent housing objectives.

MULTIPLE GOALS

The multiple goals are perhaps the greatest reason for the proliferation and the confused state of housing law and housing programs. Many housing laws have assigned to individual housing programs the awesome job of achieving higher or stable housing production, higher wages for construction workers, equal opportunity, urban renewal and a higher quality environment -- while at the same time taking care to protect the consumer and further the free enterprise system and all this without unbalancing the Federal budget and not upsetting public opinion.

GOVERNMENT PARTICIPATION V. INDEPENDENT PRIVATE ENTERPRISE: The conflict between Government participation in the housing market and an independent private enterprise system presented the major issue for the 1931 President's Conference on Home Building and Home Ownership. With the unprecedented concern for the plight of the home building industry and the national economy during the Depression, the reports of the conference are nevertheless replete with expressions of fear concerning any Government participation in housing credit operations. But with the background of conditions then existing, the Congress for the first time put the Federal Government substantially into this field of operations.

This conflict of goals still presents an issue in most new program proposals being considered. With respect to any proposal, the position taken by an individual within the range of these goals is directly related to his political and economic philosophy. Production incentives are often tempered with protection to "private enterprise," meaning those similar operations handled without the benefits of the new program. The degree of Federal participation is weighed against the urgency of the need and the extent of pressure for the proposal from constituents or private or public special interest groups.

PROGRAM GOALS V. BUDGET GOALS: Normally, the breadth or authorized volume of any program using appropriated funds is modified by goals of the Federal budget. This is true

of any program involving grants, loans, or other forms of Federal expenditure such as through the special assistance functions of the Government National Mortgage Association.

In addition to dollar controls, budget goals may determine the very nature of the program. Budget officials historically have opposed direct loan programs, without regard to the Administration in power at any given time, because of their initial budget impact.

PRODUCTION GOALS V. CONSUMER PROTECTIONS OR BENEFITS:

Normally, consumer protections involve some additional burden on the lender, builder, or manager of the housing. For example, builders have objected to the existing requirement that they give the home purchaser a warranty against structural defects and the requirement that the purchaser receive a copy of the HUD "appraised value" of the property. Such items may be objected to because they involve red tape and may involve real financial loss to builders. These and many other mortgage insurance requirements determine whether a sponsor decides to use a Federal mortgage program. To the degree that a builder chooses not to use a given program, the additional consumer protection results in the curtailment of housing production under the program.

PRODUCTION GOALS V. EQUAL OPPORTUNITY GOALS: Equal opportunity regulations present a good example of conflicting goals in housing policies: the major purpose of subsidy housing programs -- to make more adequate housing available for low or lower income families -- sometimes conflicts with equal opportunity objectives. This is true where equal opportunity regulations prohibit the location of federally assisted housing in areas of racial concentration, even though those racially concentrated areas might be the ones where there is the greatest need for low- and moderate-income housing and might also be the areas where the community is most willing to accept such federally assisted housing. As a result of equal opportunity objectives, particularly where implemented by HUD's project selection criteria for subsidized housing, total volume production is reduced in some communities.

Moreover, equal opportunity regulations, like affirmative marketing requirements, apply only to federally assisted housing and those regulations add to the red tape already associated with Federal programs and therefore cost lenders and builders more time and more money to use the program.

As a result, lenders and builders often opt to construct privately financed housing, thereby reducing the volume of housing built in the FHA-supported low- and moderate-income ranges.

PRODUCTION GOALS V. ENVIRONMENTAL QUALITY GOALS: Just as there is a tension between equal opportunity objectives and housing production objectives, so is there a tension between environmental quality objectives and housing production objectives.

The National Environmental Policy Act of 1969 requires all Federal agencies to evaluate the environmental impact of all major actions affecting the quality of the environment. To implement the Act, HUD has established procedures and standards for environmental review of all applications for housing insurance or assistance, except those concerning one to four family dwellings. Detailed environmental impact statements are required to be filed for most housing projects of over 100 units.

As in the case of equal opportunity regulations, the environmental regulations apply only to federally assisted housing, thereby making the Federal programs more time-consuming and costly for sponsors to use.

PRODUCTION GOALS V. STABILIZING WAGES FOR CONSTRUCTION LABOR: Ever since the National Housing Act of 1934 creating the FHA, among the goals of most Federal housing programs has been the stimulation of overall activity in the construction industry and stabilization of its wages. As a result, sponsors constructing federally assisted projects other than one to four family homes have been required to pay the prevailing wage rate for the local labor market area, as determined by the Labor Department under the provisions of the Davis-Bacon Act of 1931. This prevents wages on such projects from undercutting prevailing wages.

Like the equal opportunity and environmental quality regulations, the Davis-Bacon Act applies only to federally assisted housing. Moreover, in some communities application of the prevailing wage determination acts to raise the cost of labor, thereby making production of housing more costly.

PUBLIC AND POLITICAL ACCEPTANCE V. EFFICIENCY AND COST SAVINGS: In choosing the program technique for an established objective, it is not unusual for the choice to be made on the basis of what the affected private sector or what public opinion may accept. This is done even

though that may not necessarily be the most equitable, efficient or least expensive operation in either the short- or long-term.

For example, ever since 1950, direct Federal loan programs for a broad range of housing have been introduced in the Congress and rejected or ignored, a paramount reason being the adverse reaction of private lending institutions. Alternatives that are used include the indirect and more complicated procedures of the Government's secondary marketing operations which provide the subsidy, but in addition a financial yield to private lenders. The highlight of this approach, of course, was the Section 221(d)(3) program, where the lender's profit was chiefly through servicing privileges and construction financing opportunities with virtually no private risk.

For example, the forms of subsidy which are less overt and visible have often been preferred to direct and identified subsidy payments. Examples include the disguised subsidy provided through the below market mortgage rates under Section 221(d)(3) and the Government National Mortgage Association Tandem Plans, and the similar subsidy provided by the FmHA through its financing arrangements in which the subsidy finally surfaces in the form of an appropriation for restoration of losses incurred by the Rural Housing Insurance Fund.

POLITICAL REALITY V. CONSISTENCY: Major inconsistencies in housing legislation flow from the known position of the Congress toward benefiting certain groups as compared to others. Direct loans at low interest rates to farmers were accepted and non-controversial at an early time when such assistance to low-income families generally was extremely controversial. Similarly, the absence of premium charges for veterans, plus other benefits, under the VA loan guarantee program represented a special approach for one group only.

PROGRAMMATIC DIFFERENCES

Apart from possible conflicts among the ultimate and multiple objectives of Federal housing programs, there exist less important but nevertheless significant differences and inconsistencies among the numerous programs, causing unnecessary confusion.

"MUTUALITY": Only the regular Section 203 home mortgage programs and the management-type cooperative housing program under Section 213 have a "mutuality" feature designed to return to the home purchaser or mortgagor, in effect, the

unneeded portion of the premiums he paid. In the case of Section 203, this feature was contemplated in the original 1934 enactment as an additional means of establishing an adequate insurance reserve. Since there had been no significant experience with fixing premiums under mortgage insurance, the mutuality feature was intended to permit premiums to be sufficiently high for soundness of the system while at the same time assuring the homeowner that his premiums were not excessive.

As experience with the Section 203 program developed, mutuality proved to be unnecessary as a prop for determining appropriate premium amounts. FHA insurance became an accepted part of home financing, and mutuality was not necessary to "sell" the program to consumers. Yet it continued with all its original requirements for establishing "group accounts" for similar type mortgages and for keeping records on individual transactions in order to compute and make such payments to each individual mortgagor as the credit balance in his particular group account warranted. In 1954, the "group accounts" were abolished but otherwise the system remains. Today it serves no purpose.

Mutuality is objectionable principally as an anachronism, but it is also objectionable as an operating procedure. It applies only to the above programs in a manner inconsistent with operations under other programs, requiring different record keeping and a separate staff to handle the payment of distributive shares of funds to mortgagors.

COST LIMITS: Construction cost limits under some of the housing programs are inconsistent. For example, under the low rent public housing program these limits are fixed on the basis of prototype costs established for each area on the basis of representative costs. Under mortgage insurance programs such as Sections 235 and 236, the maximum mortgage amount is limited to a fixed-dollar ceiling for the whole country with occasional authority to go to some fixed higher amount in high-cost areas. Such ceilings vary among programs. Generally, the discretion given here is not adequate to permit full adjustment to cost variations, and this actually prevents construction under some programs in certain areas. Conversely, in other low-cost areas the dollar ceilings are so high they are deemed to be inequitable when compared to nationwide figures.

"ECONOMIC SOUNDNESS": Under the Sections 203 and 207 mortgage insurance programs, the property or projects with respect to which the mortgage is executed must be "economically

sound." This underwriting standard still exists with respect to those programs but it has been generally waived for each of the special purpose mortgage insurance programs, and an "acceptable risk" standard has been substituted. The most significant waiver to date of the economic soundness standard was made by Section 223(e) which also permits waiver of other eligibility requirements to encourage more mortgage insurance in any "older, declining area." The area had to be "reasonably viable" and the property "an acceptable risk," giving consideration to the needs of "families of low- and moderate-income in such area." The substitution of "acceptable risk" for "economic soundness" produced confusion and inconsistency because, although the Congress intended the substitution to encourage liberalization, it certainly did not intend to authorize the insurance of unsound loans. The extent to which "acceptable risk" is something less than "economic soundness" is vague in the statutes, because the legislation gives no standard at all for determining that difference, or provides only vague language such as "taking into consideration the need for housing low-income people." Some contend the terms in quotes are interchangeable, because risk is always present in insurance, and at the same time the insurance should always be reasonably sound. In practice, however, "acceptable risk" has been applied quite differently than "economic soundness."

"APPRAISED VALUE": According to another underwriting concept, the insured mortgage under the original FHA programs could not exceed in amount the appraised value of the property. That standard took into account the long-range value of the property over the life of the mortgage. However, a "replacement cost" maximum amount was generally substituted for "appraised value" in the special mortgage insurance programs enacted after the original Sections 203 and 207 programs and aimed at special groups or special areas, such as declining inner city neighborhoods. A maximum mortgage amount computed on the basis of replacement cost, as opposed to one computed on the basis of "appraised value", usually results in a higher maximum mortgage amount. This occurs particularly because "replacement cost" ignores future value of the property, the use of that technique lowers the underwriting standards applied and establishes an important inconsistency in mortgage insurance operations and in the standards of the mortgage instruments insured by HUD and sold in the secondary market throughout the country. This was deliberately authorized by the Congress to encourage sponsors to participate in the special purpose programs, particularly those operating in urban renewal areas.

MAXIMUM DOLLAR MORTGAGE AMOUNTS: Each of the many mortgage insurance programs has flat dollar limits on the amount of eligible mortgages. In the case of home mortgages, these ceilings range from \$14,400 to \$33,000 for a single-family unit with a 50 percent increase permitted in Alaska, Hawaii and Guam. While amendments have brought about some consistency from time to time, there are still differences which cannot be explained on any basis other than the average costs at various time of the enactments or the policies prevalent at those times. Examples are the discrepancies between the dollar ceilings in the regular Section 203 home mortgage program, the Section 220 home mortgage program for urban renewal areas, and the home mortgages under Section 221 for moderate-income families, especially as to structures for more than one family.

The dollar ceilings with respect to the multifamily housing programs present a different problem of inconsistency. Each program has such an array of varying ceilings that they defy meaningful comparison. These ceilings have fixed maximum amounts per mortgage program, varying from \$12.5 million to \$50 million, but the more significant variations are geared to amounts per dwelling unit for units of varying sizes in various types of structures and areas.

DOWNPAYMENTS: Statutory provisions determining necessary downpayments by mortgagor/purchasers contain desirable variations for differences in mortgage amount and some other factors, but they also contain inconsistencies. Generally, the amount of the downpayment is determined by the permissible loan-to-value ratio of the mortgage. The loan-to-value ratio varies from 75 percent (in the case of recreational housing) to as much as 100 percent (which can apply to a mortgage amount as high as \$24,000 in the case of Section 221(d)(2) housing for moderate-income families and to Section 235 subsidized housing). The 100 percent maximum loan is not applicable to a comparable mortgage amount under other programs. In the case of Section 221(d)(2), unlike other programs, specific downpayment dollar amounts are prescribed on the basis of the number of units in the structure and whether the purchaser had been displaced from his previous home. Generally, the formula for arriving at the loan-to-value ratio allowable on an individual mortgage is stated in terms of a fixed percentage of the first X dollars of appraised value, with progressively lesser percentages prescribed for additional increments of value, up to the maximum mortgage amount stipulated in the statute. However, these graduated steps

and the applicable percentages attached to each are not uniformly applied to all programs, as can be seen, for example, by comparing their use with respect to home mortgages insured under Sections 203 and 222. Some of these differences are justifiable, because of differing objectives and target groups.

TREATMENT OF FAMILIES UNDER SUBSIDY PROGRAMS: Without logic or rationale, statutory requirements controlling the treatment of families in subsidy housing programs vary greatly. In some programs, such as rent supplements and Section 235, a tenant or homeowner must contribute a stated percentage of his income either to rent or mortgage payments. In others, such as Section 221(d)(3), he need not. In some programs, very liberal deductions from family income are permitted both in determining eligibility for occupancy or other participation and the amount of rent the family must pay. In other programs, only the most limited deductions from income are permissible. In some of the subsidized programs, a tenant must leave the unit if his income rises past a certain level. In others, he need not. In some programs, the assets of an eligible family are severely limited, but not in other programs.

In the public housing program, maximum income limits are based on the income group in the area not served by private unassisted housing, and are actually fixed by each of some 3,000 housing authorities. Except with respect to public housing for the elderly and displaced, and housing leased under Section 23 public housing rentals at time of admission must be at least 20 percent below the lowest rentals in decent private housing which is unassisted and available in substantial supply. Public housing rentals generally cannot exceed 25 percent of the tenant's income. There is a wide range of public housing eligibility limits throughout the Nation as illustrated by Table I. One reason for this wide range is the geographical differences in housing costs; another is the lack of accurate data on local area rents.

In the rent supplement program, income limits are tied to the limits actually established in the community for public housing purposes, except that the definitions of income are different. In the Section 235 homeownership subsidy program and the Section 236 rental subsidy program, there is a standard based on 135 percent of public housing limits in the area, but with a limited exception related to the Section 221(d)(3) subsidized interest program.

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TABLE 1

RANGE OF ELIGIBILITY LIMITS
4-PERSON LOW RENT PUBLIC HOUSING

CITY	LIMIT
NEW YORK	\$7800
CHICAGO	6500
LOS ANGELES	6100
BOSTON	6000
DETROIT	6000
ST. LOUIS	6000
WASHINGTON, D.C.	5800
SAN FRANCISCO	5700
SEATTLE	5700
DENVER	5600
KANSAS CITY	5500
ATLANTA	5000
NEW ORLEANS	4800
PHILADELPHIA	4750
SAN ANTONIO	4700

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

LOCAL APPROVAL REQUIREMENT: Unlike the usual private housing, whether assisted with FHA insurance or not, a rent supplement project cannot be undertaken in a community unless its local governing body has approved it through adoption of an applicable "Workable Program" or otherwise. This does not apply to the Section 236 rental program which is also private housing, but does prevent use of rent supplements in connection with some Section 236 projects.

INCOME GAPS: Some specific statutory provisions are contrary to the general purpose of carrying out a program on an equitable basis of distribution. The original 20 percent gap provision in the low-rent public housing law is still in effect (with some exceptions). It eliminates an income bracket from benefits, without logic except to assure private sponsors that public housing will not approach an income group they might serve. The above limitations tying income eligibility under the FHA subsidized housing programs to ceilings fixed locally for public housing creates arbitrary gaps in program benefits, plus creating obvious inequities between and among communities.

HIDDEN SUBSIDIES AND COSTLY DEVICES TO DEFER BUDGET IMPACT: Program financing schemes to avoid the need for appropriations or to permit a technical budget reduction are inconsistent with good management, frank information as to Government costs, and efficient and economical administration. They generally result in extreme complexities.

The device of hidden (or partially hidden) subsidies in contrast to overt subsidies is common in housing as well as other Government operations. An early use in housing was through the Federal National Mortgage Association special assistance operations now being continued by Government National Mortgage Association where the subsidy is provided by purchasing mortgages at prices above their value at the time -- often at par. This contrasts with the direct loan and the subsidized interest rate housing programs. The use of the Tandem Plan in a variety of ways is one form of subsidy which is sufficiently hidden to avoid the extent of controversy that would result from a direct subsidy of equal amount.

Another hidden subsidy exists under the rural housing insured loan system of the FmHA. The Housing Act of 1965 established that system and a Rural Housing Insurance Fund to finance it. This was done mainly to avoid budget considerations which had restricted direct loans under the FmHA's original authority. Under the insurance system the

rural housing loan is made by the FmHA and secured by a note and mortgage. The note is packaged with other similar notes as collateral for a special type of Government guaranteed security. These securities are sold in the private market at rates determined by conditions in the money market at the time. The proceeds of the blanket security sales are deposited in the Fund. Since the interest cost on the blanket securities exceeds the interests realized on the underlying notes, subsidies are necessary and paid on the loan transactions. These are treated as operating costs and paid from income to the Fund to the extent available. Deficits in the Fund are restored with annual appropriations by the Congress.

A major factor shaping Federal housing subsidy programs has been the desire to so structure the subsidy mechanism as to artificially minimize the immediate impact of the program on the Federal budget. Accordingly, interest subsidy programs which spread the budget impact of the subsidy over periods as long as 40 years are often favored over other types of subsidies whose budget impact is more immediate.

INTEREST RATE CEILING: In the overall housing credit policy of the Federal Government, there is a major conflict with respect to control of interest rates. All FHA and VA-insured mortgage loans are subject to maximum interest rate controls prescribed in Federal regulations,¹⁷ while conventional loans by Federal savings and loan associations are not subject to such Federal controls, although assisted by the United States through the facilities and financial backing of the Federal Home Loan Bank System.¹⁸ This inconsistency

¹⁷These regulatory ceilings are subject to statutory ceilings; however, the Congress has authorized the Secretary of HUD and the Administration of VA to set the ceilings by administrative decision.

¹⁸President Nixon, in his August 3, 1973 "Message to the Congress on Recommendations for Change in the United States Financial System", proposed that the interest ceiling on FHA and VA mortgage loans be removed. Noting that these ceilings have failed to keep costs down and at the same time have restricted the flow of private funds into mortgage markets, the President urged individual States to follow the Federal lead and remove similar barriers to housing finance wherever such barriers exist.

has become more pronounced since the savings and loans have been given the facilities of a Government secondary market in both the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. The latter corporation was created by the Emergency Home Finance Act of 1970 to carry on, under the direction of the Board of Directors of the Federal Home Loan Bank Board, a secondary market in both conventional and Government-assisted residential mortgages. The same act gave Federal National Mortgage Association authority to deal in conventional mortgages.

VA GUARANTEE AND FHA INSURANCE: A number of important differences exist in the requirements and procedures under these two programs which cause confusion for builders, lenders, and home purchasers. It is especially troublesome to builders and purchasers because the two programs often are used in the same housing development. Major differences in the FHA and VA operations are:

- (1) The VA uses a "guaranty" system in contrast to the FHA "insurance". This means that VA loans carry full protection against loss (including interest and foreclosure costs) up to the limit of the guaranty on each loan without charge to either borrower or lender to cover VA risks; FHA requires annual mortgage insurance premiums as well as a slight co-insurance by the lender which can result in some loss of interest and a portion of foreclosure costs.
- (2) The VA guaranteed loan can be up to the full "reasonable value" of the property, in contrast to the downpayment generally required for a home purchased under FHA procedures. This becomes a more significant difference in the higher cost ranges.
- (3) The VA established the "reasonable value" for the purpose of fixing the loan amount, but this becomes, in effect, the sales price, and is distinguished from "value" established by FHA for computing maximum mortgage amount. The latter is based upon the value of the property as security for long-range insurance purposes.
- (4) The VA follows quite different procedures in event of default on the loan and foreclosure proceedings.

DUPLICATIONS

Although not as serious as conflicts and inconsistencies in the housing laws, duplicating provisions are so extensive and so pervasive in those laws that they constitute a major problem. Duplicative provisions have varying effects. In the case of the many FHA mortgage insurance programs there is an unnecessary repetition of program provisions, including eligible mortgage terms for each program almost as though there were that many separate agencies administering similar programs. This results not only in massive bureaucratic rules and regulations, but inevitably leads to inconsistencies and further confusion because of the way pressures for amendatory legislation and enactment occur.

Apart from programmatic duplication within HUD, there also is functional duplication among the primary "housing" agencies -- HUD, VA, and the Agriculture Department, especially in communities under 10,000 population.

CHAPTER 2

INDIRECT FEDERAL HOUSING ACTIVITIES

The Federal Government intervenes in the housing market in many different ways -- through tax policies, regulation of mortgage financing, mortgage insurance, subsidy payments, welfare assistance, credit policy, labor policy, equal housing opportunity policy, environmental policy and numerous other lesser activities.

Some of these interventions assist consumers in acquiring housing, others assist lenders and builders in providing it and still others alter or influence the conditions in which the housing market operates. In short, the Federal Government directly and indirectly exercises a major influence over the production and consumption of housing.

Analysis of Federal housing policy has tended to focus upon the direct Federal housing programs, such as those administered by HUD, the Department of Agriculture and the VA and upon mortgage market operations by the Federal National Mortgage Association, the Federal Home Loan Bank Board and the Government National Mortgage Association. The Federal Government role, however, is far more complex and far more pervasive than is evidenced by the direct housing programs, which form the core of housing legislation.

Because of the magnitude of the housing market, direct Federal programs often play a strictly supplementary role. A very small fraction of houses built or mortgage loans made in any one year are the result of direct Federal housing programs. The Federal Government, in some ways, exercises a greater influence through its indirect interventions in the housing market -- for example, the income tax treatment of homeowners and of investors in housing; Federal credit policies, such as those instituted by the Federal Reserve Board, which strongly affect the cost of financing a home purchase in a given period; and the interest limitation set by the Federal Government on savings and loan institutions and savings banks, which can strongly affect the availability of funds for mortgage financing.

The cost in 1972 of Federal intervention in the housing market -- direct and indirect -- totaled at least \$14 to \$15 billion and of this total only \$2.5 billion was for direct

federally operated housing subsidy programs. To the direct subsidy cost must be added some \$2.6 billion in Federal payments to State and local governments which is used by welfare recipients for housing. Exceeding the cost of such direct programs, however, was an indirect cost of \$6.2 billion -- the amount of revenue forgone by the Treasury Department due to income tax deductions by individuals for mortgage interest payments and local property taxes. In addition, there were revenues lost from special capital gains tax treatment on the sale of homes, another form of indirect assistance to the housing market. Federal support of the mortgage market also has a major, albeit indirect impact, but it is not precisely measurable in budget outlays or tax revenue losses.

The following illustrates the relative order of magnitude of the Federal interventions:

	Cost in Calendar Year 1972 (in billions)
Homeowners' deductions	\$6.2
Federal subsidized housing programs	2.5
Federal welfare assistance payments for housing	2.6
Other taxes forgone (e.g. capital gains on home sales)	3.0 to 4.0

Certain other Federal policies, although ostensibly unrelated to housing, have -- or promise to have -- great impact on the Nation's construction and supply of housing. For example, environmental considerations have become a major new factor in both federally sponsored and privately developed housing. As a result of the National Environmental Policy Act of 1969, all Federal agencies are required to consider the impact of their policies and programs on the physical, social and economic environment; this includes federally assisted housing projects. Environmental considerations -- including requirements flowing from Federal regulation of the quality of air, water, noise and other materials and processes, as well as those requirements of legislation now pending in Congress which would affect land use and other environmental concerns will assume -- and in many places already have assumed -- a major role in determining the location, design and cost of housing.

Similarly, through its labor policies, the Federal Government exerts an influence over the cost of housing. Under the Davis-Bacon Act of 1931, administered by the Labor Department, the prevailing on-site wage rate must be paid on all federally assisted projects. (Coverage does not extend to one-to-four family units constructed under federally insured or subsidized financing.) Although this requirement applies directly only to federally financed housing, it may indirectly influence labor costs for all other construction.

Another factor influencing the sale or rental of housing has been anti-discrimination policies enforced by the Federal Government. Through a number of legislative acts and administrative and judicial decisions, the Federal Government has moved to eliminate racial discrimination in the sale or rental of housing, thus seeking to assure the availability of housing on an equitable basis to minority groups. This "fair housing" mandate has added a social objective with far-reaching implications for future housing development to the original economic objectives of the Nation's housing policies.

The proliferation of Federal policies with widely diverse goals and origins having major impact on housing has brought with it a fragmentation of the responsibility for developing housing policy both within the Executive Branch and in Congress. For example, HUD administers programs to encourage the construction and ownership of homes through various forms of Federal assistance. The Treasury Department administers tax policies that have important effects on homeownership and housing construction. The Department of Health, Education and Welfare has the responsibility for programs that in part provide housing for the needy, while at the same time HUD is subsidizing housing for low-income families. The Bureau of Indian Affairs of the Department of Interior, the Department of Agriculture, the Veterans Administration and the Department of Defense are also involved in housing.

Similarly, Congressional responsibility for the various facets of housing policy is divided among various committees. The basic housing legislation is developed by the banking committees in the House and Senate, while tax and welfare

legislation affecting housing is drafted by the House Ways and Means Committee and the Senate Finance Committee.¹

This divided responsibility stems, in part, from the highly complex nature of the housing sector itself. This complexity and the fragmentation of current Government involvement have made it more difficult for the Government to develop a comprehensive housing policy. To the degree that public debate on housing policy has concentrated on direct Federal housing programs and mortgage market activity, the breadth and scale of Government intervention -- and the scale of fragmentation -- has tended to become obscured. This chapter focuses on some of the major points of indirect Federal intervention in the housing market with particular emphasis on Federal tax policy.

A number of Federal programs not discussed here also have had an indirect but often very substantial impact on housing: highway, mass transit and airport subsidies; relocation assistance; urban renewal; and community development subsidies such as sewer and water grants, public facility grants, open space assistance, and urban planning grants. These involve direct Federal expenditures, however, whereas the Federal role discussed here is, for the most part, either regulatory in nature or involves tax revenue forgone rather than direct expenditures.

TAX POLICIES

Through its tax laws, the Federal Government exercises a major influence over the housing market. The impact on housing is a pervasive one and comes through special benefits

¹There are twelve Congressional Committees with legislative responsibility involved in housing: six in the Senate (Agriculture and Forestry; Appropriations; Banking, Housing and Urban Affairs; Finance; Judiciary; and Veterans Affairs) and six in the House (Agriculture; Appropriations; Banking and Currency; Judiciary; Veterans' Affairs; and Ways and Means). A number of other Congressional Committees exercising an oversight function have, in recent years, also addressed themselves to housing, in particular the Joint Economic Committee and the Subcommittee on Housing for the Elderly of the Senate Special Committee on Aging. Legislative committees peripherally involved in housing are the Armed Services and the Interior and Insular Affairs committees in the House and Senate.

and deductions granted on income taxes for businesses as well as for the individual. By providing tax write-offs, the Federal Government encourages investment in housing, thereby increasing the supply of housing. By granting special deductions to homeowners, the Government promotes homeownership.

Originally, tax policies generally were thought of as a way to give special benefits to an individual, rather than as an instrument to help achieve explicit housing goals. In recent years, however, a convergence has developed between tax policy and housing policy and with it a clearer realization of how they are interrelated.

Tax policies increasingly have been used as an instrument to promote housing goals. For example, when the tax laws were revised in 1969, one provision (Section 167 of the Internal Revenue Code) was rewritten for the express purpose of attracting investment capital into residential housing. The provision constituted a deliberate decision by Congress to use the tax laws to promote the construction of housing, particularly for low- and moderate-income families.

Using the tax laws as a tool to achieve desirable social objectives inevitably raises the question of equity. Tax benefits for housing mean forgone Federal revenues that might be used to achieve other objectives or to benefit groups other than homeowners. A problem arises in weighing the value of different goals. There are questions as to whether the tax benefits create inequities between economic groups. Do they benefit higher income families who can afford homes without such assistance at the expense of others who cannot? Do they discriminate against renters? Do they give the housing industry a tax advantage to which other industries fulfilling other basic needs -- such as food processors or clothing manufacturers -- might be equally entitled? Do they encourage new construction at the expense of rehabilitation?

As housing programs and the tax code become increasingly complex and intertwined, such questions of social and economic equity will become increasingly important in the development of a coherent housing policy.

INCOME TAX INCENTIVES FOR HOMEOWNERS

The Internal Revenue Code reflects an evolution of a policy, which began with the first income tax experiments during the Civil War, providing that certain tax benefits should accrue to homeownership at the expense of potential Federal revenues and other forms of consumption or investment. In the Revenue Acts of 1864 and 1865, taxpayers were

permitted to deduct interest expense and local tax payments. Of these, two categories of expenses related to homeownership: mortgage interest payments and property taxes. The policy was enunciated again in the first statute implementing the 1913 Constitutional amendment which established the Federal income tax system we know today. The policy has remained virtually unchanged.

In 1972, more than 24 million taxpayers who lived in their own homes -- or almost one-third of all taxpayers -- took advantage of these two tax benefits, now contained in Sections 163 and 164 of the Internal Revenue Code.

In recent years, a third category of tax benefit was conferred on homeowners when Congress approved legislation permitting a homeowner to defer the tax on any gain realized in the sale of his principal residence. The Congress approved the new provision (Section 1034 of the Internal Revenue Code) in 1951 at the height of the Korean War with the stated intent of alleviating the hardships associated with relocations brought on by wartime mobilization and facilitating the purchase of larger homes by growing families.

Pursuant to Section 1034, a homeowner who sells his home and purchases, generally within one year, another of equal or higher price will not be taxed at that point on any capital gain realized (calculated generally as the difference between the original cost of the home plus the cost of capital improvements and the purchase price of the new home). The tax is thus deferred into the future to the time when a homeowner finally sells a home without buying another of equal or greater price or when he buys a home at a lower price. In addition, when a homeowner who has been deferring his taxes under Section 1034 dies, the gains realized are totally excluded from taxation pursuant to Section 1014 of the Internal Revenue Code. In sum, the effect of Section 1034 is to promote both social and geographic mobility and to widen the housing market by providing homeowners an incentive, when they move, to buy another home of equal or greater price.

Section 1034 created a potential problem, however, for the elderly person who may have wished to sell his present home and move to smaller, less costly accommodations, investing the gain from the sale to provide for his retirement. Thus, Congress in the 1964 Revenue Act provided (in Section 121 of the Internal Revenue Code) that any gain realized by an elderly taxpayer (65 or older) on a house sold for under \$20,000 would not be taxed and only a portion of the gain on homes sold for more than \$20,000 would be

taxed, depending on the amount of the gain and the adjusted sales price. A taxpayer, however, may utilize this provision only once. The result of this provision was to enhance the value of an investment in a house, which represents the most important and, in some cases, the only major investment made by the majority of taxpayers.

Clearly, then, the benefits conferred upon homeowners by the Federal income tax laws have substantial economic and social impact. Table 1 gives an indication of the magnitude of the impact of the mortgage interest and property tax deductions.

Not included in the table is the estimated loss of revenue in 1973 from homeowners who were entitled to defer or exclude the Federal tax on any capital gains realized from the sale or other disposition of their homes. If all such gains realized in 1973 were taxed, the Department of the Treasury has estimated that revenues for 1973 would increase, as a consequence, by about \$1.7 billion. If, in addition, homeowners who have over the years compounded their gains through the sale of several homes were taxed on their gains in previous years, 1973 revenues would increase by an additional \$1.3 billion, although this, basically, would be a one-time increase.

The relative tax savings generated by the homeowners' deductions, as Table 1 shows, go primarily to middle- and upper-income taxpayers. There are three reasons for this. First, homeownership is less widespread among low-income groups; second, low-income homeowners tend to have less expensive homes allowing less opportunity for tax savings; and, third, low-income homeowners have low Federal tax rates and, therefore, less to gain from deductions. A taxpayer in the 10 percent tax bracket, for example, who has deductions of \$1,000 will realize a tax saving of \$100, while taxpayers in the 50 percent bracket with \$1,000 in deductions will realize a tax savings of \$500.

The percentage of taxpayers in each income bracket who benefit from the deductions goes up sharply as income rises. In 1972, only 1.1 percent of all taxpayers with adjusted gross income of less than \$3,000 benefited from the deductions whereas 90.2 percent of those in the \$100,000-or-more bracket benefited. As the table demonstrates, the bulk of the \$6.2 billion in total benefits -- \$5.5 billion -- went to taxpayers with adjusted gross incomes of \$10,000 or more. The lower income taxpayer, however, may realize certain progressive tax savings through the standard deduction, which remains constant for all income groups.

TABLE 1

REVENUE COST OF ALLOWING HOME OWNERS DEDUCTIONS FOR MORTGAGE INTEREST AND REAL ESTATE TAXES, 1972

ADJUSTED GROSS INCOME CLASS	RETURNS WITH A TAX INCREASE				COST OF DEDUCTIONS AS A PERCENT OF TAX LIABILITY
	NUMBER OF RETURNS (THOUSANDS)	PERCENT OF ALL RETURNS IN INCOME CLASS	TOTAL COSTS OF THE DEDUCTIONS (MILLIONS)	AVERAGE COSTS OF THE DEDUCTIONS	
UNDER \$3,000	193	1.1%	\$ 4.4	\$ 23	2.0%
3,000 - 4,999	467	4.9	23.8	51	1.3
5,000 - 6,999	1,670	18.9	131.7	79	3.5
7,000 - 9,999	4,725	35.7	565.2	120	5.7
10,000 - 14,999	7,396	48.1	1,130.0	153	5.7
15,000 - 19,999	5,038	70.0	1,323.1	263	8.2
20,000 - 49,999	4,241	78.7	2,236.7	527	9.5
50,000 - 99,999	382	87.0	533.1	1,397	6.7
100,000 OR MORE	92	90.2	231.2	2,502	3.0
TOTALS	24,205	31.0	6,179.2	255	6.8

* EXPRESSED AS A PERCENTAGE OF TOTAL TAX LIABILITY AFTER CREDITS FOR ALL RETURNS IN THE ADJUSTED GROSS INCOME CLASS.

SOURCE: DEPARTMENT OF THE TREASURY.

The most costly in terms of forgone revenue but the least well-defined tax benefit that accrues to homeowners, some tax reform advocates contend, occurs by virtue of the absence of a tax on the "income" derived from investment in a home. This is the so-called "imputed net rental" argument. The argument is made that if a home is treated as a taxable asset or investment and deductions for interest and property taxes are allowed, then it should also be taxed on its income-producing potential. Imputed net rental is the difference between the gross rent that an owner-occupant could receive if he rented his home and the overall cost of producing that income, including depreciation, maintenance and repair costs (which are not deductible for homeowners). Some tax analysts contend that all homeowners should be required to count such potential rental income as part of their gross income for Federal tax purposes just as investment income from other types of assets must be counted.²

A study conducted for the National Housing Policy Review projected the estimated revenue loss for 1973 due to the exclusion of net imputed rent at \$6.04 billion.³

TAX PREFERENCES FOR HOMEOWNERS: OUTLINES OF DEBATE

The result of the homeowner tax preferences is to reduce the cost of owning a home from what it otherwise would be and, thereby, help make owning a home appear more attractive to consumers than renting one. It is difficult, however, to draw precise comparisons between the cost of renting and buying. The renter, for example, has the advantage of being able to invest and obtain an immediate return on the money that a homeowner must use for a downpayment. However, the renter-investor must pay taxes on this return, while the homeowner- "investor" receives his "return" tax free. The tax advantage of homeownership over renting also varies with income and the size of the downpayment required. The renter cannot deduct the portion of his rent which goes to meet mortgage interest and property tax expenses. On the other hand the owners of rental property deduct such expenses and, to the extent a particular housing market is competitive,

²Henry Aaron, Shelter and Subsidies: Who Benefits from Federal Housing Policies, Washington, D.C.: The Brookings Institution, 1972.

³Urban Systems Research and Engineering, Inc., "Housing and Federal Taxation: Costs and Effectiveness," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

the renters may benefit indirectly from the tax benefits accorded the owners.

The National Housing Policy Review study of the revenue costs of the homeowner tax preferences concludes that, counting the exclusion of imputed rent from gross income, homeowner tax benefits reduce the gross costs on owner-occupied units by from 10 to 15 percent.⁴ The study held that these tax benefits bring about a 5 to 7 percent increase in the probability of homeownership. Consequently, the study concludes, there were 3.2 million to 4 million owner-occupied units in 1970 that, in the absence of homeowner tax benefits, would in all probability have been rental units.

There has been considerable debate over four major policy issues related to the existing system of homeowner tax benefits. First, should imputed rent be included in a homeowner's taxable gross income for tax purposes? Second, should the existing system of homeowner tax deductions for property tax and interest be expanded, eliminated, or modified? Third, should Section 1034 of the tax code, which permits a homeowner to defer the payment of taxes on capital gains realized on the sale of an owner-occupied house, be expanded, eliminated or modified? And, fourth, should Section 121 of the tax code, which eliminates all or part of the gain realized on the sale of an owner-occupied unit by an elderly family, be modified or expanded?

Basically, proponents of tax reform argue that the present system of taxing owner-occupied units is inequitable because it favors homeowners over renters, provides proportionately greater rewards to higher-income taxpayers than it does to lower-income taxpayers and favors investments in housing over investments in other types of assets.⁵

IMPUTED RENT: Some tax reform advocates suggest that either the net imputed rental value of a property be taxed or deductions for mortgage interest and property taxes be disallowed.

Proponents of this change contend that if net imputed rent were taxed, the tax law would treat renters and homeowners in an even-handed manner. Investment in owner-occupied

⁴Housing and Federal Taxation: Costs and Effectiveness," op. cit.

⁵For more detailed discussion, see Richard E. Slitor, "Rationale of the Present Tax Benefits for Homeowners," a study prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

homes and in other types of assets would then be taxed in a similar fashion and a substantial additional amount of revenue would be generated, as has been noted.

Those who oppose taxing net imputed rent argue as follows: First, "service" income is not otherwise taxed under the Internal Revenue Code. Second, it is inequitable to tax the use of an owner-occupied unit unless the imputed value of all types of property, including cars, boats, planes, recreational vehicles, television sets, radios, etc., is also taxed. Third, even if the significant administrative problems of establishing fair and equitable valuations of gross rentals on all properties could be overcome, the differences in value of basically comparable accommodations in different parts of the country and among metropolitan, suburban, and rural communities would create in itself a serious equity problem. And, fourth, home buyers who had made long-range financial commitments on the basis of the existing tax law would be placed in an unfavorable and essentially unfair financial position if the full net imputed rental value of their property were taxed, unless a long transition period preceded the change.

MORTGAGE INTEREST AND PROPERTY TAXES: Supporters of the existing law make the following points in defense of the mortgage interest and property tax deductions. First, permitting mortgage interest and property tax deductions is consistent with the tax treatment of other personal assets, as well as with the general principle underlying the current tax system -- that taxpayers should not pay a tax on a tax. Second, disallowing the deductions, it is argued, could lead to a reduction in the number of homeownership units which, conceivably, could have an undesirable impact on the sense of identity and stability in a community that, it is asserted, homeownership helps to foster. It would also mean that fewer would have the hedge against inflation that homeownership provides in those cases where rising equity in a home kept pace with price increases. Third, homeowner deductions, which tax analysts say have a regressive effect on the tax system by rewarding those with large incomes more than those with small incomes, should not be the sole target of reform. Other deductions, such as for charitable contributions, also have a regressive effect. Homeowner deductions should not be disallowed unless the whole system is reformed. And, fourth, elimination of the deductions would exert pressure on the rental market which at the present time is at least partially competitive with owner-occupied housing and could, therefore, result in some increases in rental schedules.

Critics of the mortgage interest and property tax deductions, in addition to their general argument about the basic inequitability of homeowner's preferences, also contend that the mortgage interest and property tax deductions -- because they confer greater benefits on those in middle and high income brackets--lead to an overconsumption of housing by higher-bracket taxpayers. This, critics say, has contributed, in turn, to suburban sprawl and urban decay by encouraging the quest for bigger homes in outlying areas and accelerating the turnover of existing housing in urban areas.

CAPITAL GAINS POSTPONEMENT: Proponents of reform maintain that Section 1034, which, as described earlier, permits postponement of a tax on capital gains realized in the sale of an owner-occupied home, has the following disadvantages: First, it results in a substantial estimated revenue loss. (See Table 2) Second, it may encourage some unnecessary movement on the part of families who move to larger accommodations instead of improving their present homes. And, third, it results in overconsumption of housing, particularly when a family moves from a high-cost area to a lower cost area of the country.

There are, it is argued, two major advantages of Section 1034: first, it may encourage "filtering down" of owner-occupied units to lower income groups, an effect described in more detail in Chapters 4 and 6, and, second, it may encourage mobility, thereby enabling families to move to new locations or areas where better or more remunerative jobs may be available.

Section 121 as described earlier, allows an elderly taxpayer a whole or partial exemption from taxation on the gain realized in the sale of his home, depending on the size of the gain and the adjusted sales price.

The prime advantage of Section 121 is that it provides an incentive to an elderly taxpayer who is "over-housed" to move into smaller, less costly accommodations. The elderly taxpayer's home can then be utilized appropriately by a younger, larger family. The prime disadvantage of the provision is the tax loss to the Treasury. In addition, on the premise that elderly families lend stability to marginal neighborhoods, the provision has a negative impact by making it easier for such families to leave a neighborhood.

DEDUCTION CEILINGS: A ceiling on the total amount of mortgage interest and property tax deductions a homeowner could claim (similar to the percentage-of-income ceiling

TABLE 2

OPTIONS FOR LIMITING THE AMOUNT OF PROPERTY TAX AND MORTGAGE INTEREST DEDUCTIBLE BY INDIVIDUAL TAXPAYERS

LIMIT ON HOMEOWNER INTEREST AND PROPERTY TAX DEDUCTION	1972 TAXPAYERS AFFECTED BY LIMIT		ADDITIONAL TAX REVENUES (\$ MILLIONS)	ADDITIONAL AVERAGE TAX FOR TAXPAYERS AFFECTED
	NUMBER IN THOUSANDS	PERCENT		
\$2,500	2,125	2.7%	\$749	\$352
3,000	1,225	1.6	551	409
2,500 TO 3,250	2,103	2.7	464	220
3,000 TO 3,750	1,215	1.6	330	271
4,000	423	.5	264	623

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM DEPARTMENT OF THE TREASURY.

on medical expense deductions) is one of the basic changes favored among advocates of tax reform.

According to an analysis prepared by the Treasury Department for HUD, (Table 2) an absolute ceiling (as opposed to percentage-of-income ceiling) of \$2,500 on property tax and mortgage interest deductions, had it been in effect in 1972, would have required 2.7 percent of the taxpayers to pay higher taxes and it would have generated an additional \$749 million in revenue. For those taxpayers affected, the average increase in annual taxes would have totaled \$352. Fewer than 100,000 homeowners earning under \$10,000 (0.2 percent of all taxpayers in that bracket) would have paid additional taxes and in these few instances the additional amount would have averaged less than \$100 for each. No taxpayers earning under \$5,000 would have paid additional taxes due to the ceiling. One half of one percent of those earning between \$7,000 and \$10,000 would have paid more and 1.4 percent of those between \$10,000 and \$15,000 would have paid more. But 20 percent of those in the \$20,000 to \$50,000 bracket, 39 percent in the \$50,000 to \$100,000 range and 52 percent of those above \$100,000 would have paid substantially more. Table 2 shows the impact of alternative ceiling levels.

INCOME TAX INCENTIVES FOR RESIDENTIAL RENTAL HOUSING DEVELOPMENT

Investment decisions concerning real estate traditionally have been strongly influenced by tax considerations. Prior to enactment of the Tax Reform Act of 1969, the tax code did not provide different tax incentives for residential and non-residential property although the incentives available for investment in new properties were greater than those provided for used property investments. As a result, investment in higher risk, less profitable ventures such as housing, particularly housing for low- and moderate-income families, was discouraged by the tax laws. Furthermore, after the Great Depression, real estate investment tended to go into business development, such as office buildings, rather than into residential housing. The pre-1969 tax provisions offered no incentive, and in fact may have been a deterrent, to improvement of existing properties. Finally, properties such as shopping centers and office buildings which would have been economically sound investments even without the tax incentives, were being marketed for the tax shelter they provided higher income bracket investors.

The 1969 Tax Reform Act amended the Internal Revenue Code to provide preferred treatment for investments in residential over non-residential properties and for certain types of subsidized housing over other residential property. The Act also increased the pre-1969 preference for investments in new versus used properties (except in the case of the 5 year write-off of rehabilitation expenditures on low-income housing). This preferred treatment was generally established by decreasing the availability and attractiveness of accelerated depreciation deductions for certain classes of real property rather than by increasing the incentives available for residential, subsidized and new properties.

Prior to 1969, depreciation could be computed by either the straight line or an accelerated method. Generally, in the case of newly constructed property, the taxpayer could employ the "sum-of-the-years-digits" method or the "double declining balance" method (200 percent of the straight line rate). In the case of used property, the declining balance method of 150 percent of straight line was available. Again, under prior law a portion of the gain realized on the sale of real property was "recaptured" and taxed as ordinary income rather than as a capital gain, unless the asset was held for a period of 10 years. The amount recaptured as ordinary income was equal to the lesser of the amount of gain recognized or the amount of "additional depreciation" (the amount of depreciation in excess of straight line depreciation) taken on the asset, multiplied by a certain percentage as determined by the length of time the property was held. This percentage declined at the rate of 1 percent per month for every month after 20 months the property was held and was reduced to zero at the end of the tenth year.

Under the 1969 Act, the depreciation rules (Section 167 of the Internal Revenue Code) provide that: (1) new residential rental property may be depreciated utilizing the double-declining balance or sum-of-the-years-digits methods of depreciation; (2) new non-residential property may be depreciated using the 150 percent declining balance method; (3) used residential rental property with a useful life of more than 20 years can be depreciated under the 125 percent declining balance method; and (4) all non-residential property as well as used residential property with a useful life of less than 20 years must be depreciated using the straight line method.

The "recapture" rules applicable to real property are also substantially different as a result of the 1969 Act. Only housing for low- and moderate-income families which is

assisted under the Section 236 or Section 221(d)(3) rental housing assistance programs or under certain State or local programs providing housing assistance is eligible for the pre-1969 ten year phase-out recapture rule. Accelerated depreciation taken in excess of straight line depreciation ("additional depreciation") on all other residential property is fully recaptured if the property is sold within 100 months of its acquisition. Moreover, the percentage of additional depreciation taken declines at the rate of 1 percent per month. Thus, full "phase-out" or recapture of additional depreciation does not occur until 16-2/3 years after the property is acquired. All additional depreciation taken on non-residential property is fully recaptured as ordinary income regardless of the period of time the property is held.

Two additional provisions were added to the Internal Revenue Code in 1969 which relate to housing for low- and moderate-income families. Section 167(k), enacted to stimulate investment in rehabilitation of existing housing for low- and moderate-income families, permits a taxpayer to elect to compute depreciation attributable to qualified rehabilitation expenditures (incurred in connection with the rehabilitation of existing dwelling units for low- and moderate-income families) under the straight line method, using a useful life of 60 months. The advantage of this provision is that it permits a taxpayer to depreciate an asset (for which qualified rehabilitation expenditures are made) over a much shorter useful life than it would otherwise have been assigned. This is referred to as "rapid amortization." Rehabilitation expenditures cannot be less than \$3,000 nor more than \$15,000 per unit to qualify for Section 167(k) treatment.

Moreover, the 1969 Act added Section 1039 which permits the owner of a certain type of federally assisted rental project to elect to defer payment of a tax on the gain realized on the disposition of such housing provided that (1) the tenants living in the project or an organization formed for their benefit purchase it, and (2) the owner reinvests the sales proceeds in a similar type of housing within a given period of time. Owners of State or locally assisted housing projects cannot participate in the Section 1039 provision (commonly referred to as the "rollover provision"). Section 1039 is analogous to the capital gains deferral accorded homeowners by Section 1034. The Congressional purposes for enacting Section 1039 were to: (1) help prevent housing deterioration by promoting tenant ownership and (2) keep capital invested in federally subsidized housing. To date the Section 1039 provision has

not been utilized. This may in part be due to the fact that in the short period since the Tax Reform Act of 1969 the optimum time at which to dispose of a subsidized project has not yet been reached.

IMPACT OF TAX REFORM ACT OF 1969

A recent analysis of the effect of the Tax Reform Act of 1969 on housing production concludes that the Act has diverted substantial resources from non-residential to residential structures. The diversion for 1972 is roughly estimated at \$1.2 billion, which is the equivalent of 80,000 rental housing units at an average cost of \$15,000 per unit, (or 60,000 units at an average cost of \$20,000 per unit.)⁶ The study also found that the Act may also have diverted considerable capital expenditures from producers' durable equipment, which was made vulnerable by the repeal of the investment credit in the 1969 Act. While this effect is presumably now wearing off, as of 1972 it is crudely estimated that the result of this phase of the 1969 tax reform legislation was to release some \$2.75 billion of investment funds from producers' durable equipment, making it available directly or indirectly to the rental housing field. This would be equivalent to 183,333 rental housing units at \$15,000 per unit or 137,500 units at \$20,000 per unit.

The five major arguments made in support of the tax incentive system established by the 1969 Act are these. First, it has successfully attracted capital into conventional residential rental housing and, in unprecedented amounts, into subsidized housing investments. Second, it provides an incentive without direct Federal expenditure. While costs in revenue forgone represent "back door" expenditures and thus may be undesirable from a management standpoint, it is still substantially less difficult politically to provide funds for a particular activity through tax incentives than with appropriated funds requiring periodic Congressional approval. Third, the forgone-revenue costs of subsidizing housing for low- and moderate-income families represent only a small percentage of the total benefit provided. Moreover, the total forgone-revenue costs of providing accelerated depreciation for all rental housing represent less than one-tenth of the forgone-revenue costs of supporting homeownership through interest and property tax deductions. Fourth, unless all tax sheltered investments

⁶"Rationale of the Present Tax Benefits for Homeowners," op. cit.

are eliminated, or substantially curtailed, removal of the current incentives for rental housing might, in the long run, result in only a minimal tax revenue gain. Fifth, residential rental investment has traditionally been considered exceptionally risky. Some additional lure is, therefore, required.

Critics of the present tax incentive system for rental housing raise the following points in opposition. First, since the current tax incentives available for real estate investment are provided in the form of artificial tax losses, the higher the tax bracket of an investor the greater the benefit derived from such losses. Investors in lower tax brackets (those with a marginal aggregate Federal, State and local tax rate of less than 50 percent), therefore, generally find tax shelter investments unattractive. Second, since the tax benefits available in a project of a given size do not vary with the risks involved, investors will pay less for a "high risk" than a "low risk" project. Therefore, the current system encourages sponsors to avoid high risk areas most in need of housing. Third, since sponsors of low- and moderate-income housing cannot in most circumstances utilize the tax "loss" generated by a project, they must syndicate the project. Syndication involves significant "middle man" costs which reduce the net amount realized by the sponsor. If the sponsor received a direct payment equal to the net amount realized a substantial amount of the benefit would be saved. Fourth, the present system may have a negative effect on project maintenance and longevity. Fifth, capital is diverted from investment in more productive sectors than housing because of the existence of the tax shelters.

TAX LOSS AND SUBSIDIZED HOUSING

Tax benefits represent only one of a number of inducements for investors in conventional housing projects. Cash distributions from rents constitute the principal inducement for such investors with tax shelter and capital appreciation on sale viewed as lesser considerations. The tax benefits available in subsidized housing projects, however, are considered to be the prime if not the only inducement.

The more advantageous financing and recapture rules available to investors in subsidized housing adds further importance to the tax factor in this case. For example, in a Section 236 project, a 90 percent loan (which is not available in conventional projects) provides greater financing leverage and, therefore, a greater ratio of depreciation

dollar losses to equity invested. Moreover, a 40 year repayment period (instead of the conventional 20-25 year period) results in greater interest and smaller principal payments in the early years of the mortgage. This is also advantageous for investors seeking tax shelter. In addition, other profit opportunities available in conventional projects are limited in subsidized projects and as a result they generally are not anticipated by the investor. For example, cash distributions in a Section 236 project are limited to 6 percent of the initial stated equity. Experience with the Section 236 program to date, however, indicates that few, if any, projects have had any funds available for distribution to investors. (It should be noted, however, that if 6 percent cash distributions are made, an investor's rate of return would improve significantly.)

The investor in residential real estate is able to take tax losses both during the construction period and the period of rental operations. Certain expenses incurred during the construction period, such as interest and property taxes, are permitted to be taken as immediate deductions rather than capitalized and included in the project cost to be depreciated. Since project income is typically not generated during the construction period, all the deductions can be used to offset incomes from other sources. During the time the project is rented, the major tax benefit available is the depreciation action. Generally, the more rapid the method of depreciation permitted, the greater the tax loss -- and thus the shelter advantage -- provided.

In most cases, residential rental property purchased as tax shelter is owned by a limited partnership because that form of ownership, unlike a corporation, permits tax losses (including those derived from construction deductions and depreciation) to be passed through to the individual partner/taxpayer who, as a limited partner, enjoys limited liability. In such cases, the taxpayer's basis in the project, which generally is equal to his capital contribution plus his proportionate share of the project debt, is reduced dollar-for-dollar by the tax losses taken.

TAX-EXEMPT FINANCING OF HOUSING

Another significant Federal intervention is through tax-exempt financing of housing. Federal tax law, based on the long established doctrine of inter-governmental tax immunity, provides in Section 103 of the Internal Revenue Code that interest on State and local obligations is exempt from taxation. In addition, the United States Housing Act of

1937 provides that local housing authority bonds issued to finance public housing are exempt from Federal taxation. The 1937 Act also provides that obligations of the local authorities will be secured by the full faith and credit of the United States through the pledge of the Federal Government to the payment of annual contribution contracts which assure the low-rent character of public housing projects.

The Federal tax exemption of interest income from local agency bonds and other obligations was one of the factors making it easier to use private funds, instead of public, in financing local public housing projects. This financing device was of historic importance to public housing and was enormously significant in the whole field of municipal and local agency financing. One effect of the tax-exempt status of interest on public housing bonds is that investors accept a lower interest rate than they would on taxable bonds or conventional mortgages. The lower tax-exempt rates have in turn kept down the direct cost of public housing by, in effect, causing the Federal Government to supplement the annual contribution for debt service with a tax exemption in the form of forgone revenue.

Public housing authorities and State housing finance agencies are the major issuers of tax-exempt debt for housing purposes.

At the end of 1972, \$11.2 billion of federally guaranteed, tax-exempt, local housing authority securities (\$7.3 billion in bonds and \$3.9 billion in notes) were outstanding, or 6 percent of total outstanding municipal debt (including obligations issued by States, local governments and special purpose districts). In 1972, \$958.9 million worth of bonds were issued; to date, in 1973, \$563.8 million worth of bonds have been issued. Total mortgage financing on residential structures in recent years has fluctuated between \$44 billion and \$90 billion annually.

The benefit of financing public housing through tax-exempt bonds guaranteed by the Federal Government has been to provide the lowest possible interest rate on 40 year bonds, and thereby a lower annual direct Federal subsidy payment to local housing authorities. Such financing on bonds issued in 1972 reduced the 40 year budgetary cost of providing housing for low-income households by an estimated \$622.4 million (non discounted).

On the other hand, there is a substantial tax revenue loss to the Federal Government because of the tax-exempt

status of public housing financing. The 40 year (non discounted) loss for 1972 bond issuances was estimated at \$836.0 million, which exceeds by \$213.6 million the interest cost (and subsidy) saving resulting from the tax-exemption. Thus, if the financing of public housing were made taxable, the subsidy budget for public housing programs would have to be increased by the amount of the increased interest cost on taxable financing. But the overall net cost to the Government would be reduced due to the increased tax revenue gained by the elimination of tax-exempt financing.

The financing of public housing takes two forms. The first involves tax-exempt obligations of the local housing authority secured by the pledge of the Federal Government to pay the full cost of amortization, as in the conventional or turnkey programs where the housing authority is the developer or purchaser of the project. These are the only bonds in the market that are both federally guaranteed and tax-exempt. The second form involves private construction financing and permanent mortgage financing secured on the basis of a leasing commitment by a local housing authority to a developer under the Section 23 leasing program authorized by the 1965 Housing Act.

In 1969 and 1970, developers were unable to propose feasible projects for the leasing program because of high interest cost. Many turned to tax-exempt bond financing, either through the sale of the project to a nonprofit corporation qualified to issue tax-exempt bonds under Section 103 of the Internal Revenue Code, or through the sale of their mortgage on the project to the local housing authority which used its revenue bonding authority (as distinguished from its public housing bond authority) to finance the purchase of the developer's mortgage. The authority's revenue bond and the mortgage carried virtually the same interest rates. In this way the project was financed at a lower interest rate and carried lower rents than would have been required under a conventional mortgage.

There are, however, some inherent limitations in the tax-exempt financing of leased housing projects. Where the nonprofit owner issues tax-exempt bonds, he must generally amortize the full cost of the project within the term of the 20 year lease because lenders are unwilling to extend credit beyond one period of the lease term and at the expiration of the lease term deed over the project to the local housing authority because of tax regulation requirements. In order for the bonds to be marketable, the nonprofit owner must receive a pledge from the local housing authority to turn over payments received under the authority's subsidy

contract with the Federal Government in amounts sufficient to cover the debt service on the bonds. The result of this pledge is an indirect guarantee by the Federal Government of the payment on the nonprofit corporation's bond. In addition, since the local housing authority will ultimately take title to the project, it usually assumes full project ownership responsibilities.

Thus, the Federal Government, as the indirect guarantor of the payment of the bonds, and the local housing authority, as the ultimate owner of the leased project, have assumed virtually the same risks as in conventional public housing projects.

As of June 30, 1973, approximately \$250 million of leased housing had been financed by the issuance of tax-exempt bonds. Of this amount, \$225 million was raised through tax-exempt bonds issued by nonprofit project owners and approximately \$25 million through tax-exempt revenue bonds issued by local housing authorities to purchase mortgages on the projects.

ADMINISTRATION TAX REFORM PROPOSALS

In April 1973, President Nixon presented to Congress a number of proposals for tax change directed toward three basic goals: tax equity, simplification, and economic growth. Several of these proposals would modify the present nature of the Federal Government's intervention in housing through its tax policies. Two of these proposals are of substantial importance to real estate investment and two others would be of significance to the housing field.

MINIMUM TAXABLE INCOME: The Minimum Taxable Income Proposal would replace the current minimum tax for individuals with a new provision that would prevent the combination of certain exclusions and deductions permitted under the Internal Revenue Code from offsetting more than one-half of a taxpayer's income and would thus require every individual to pay a tax on at least that balance. Recipients of disproportionately large tax preferences, as a consequence, would be taxed more heavily than under the present minimum tax provisions.

The exclusions involved are those for (1) one-half of long-term capital gains, (2) the bargain element of a stock option at the time of exercise, (3) percentage depletion in excess of adjusted basis, and (4) income earned abroad and presently excluded under Section 911 of the Internal Revenue Code. Unlike the present minimum tax, the proposal

would not include accelerated depreciation on real property as a preference (or "addback") item.

In applying the provisions, the specified exclusions would be added back to the taxpayer's adjusted gross income. From that sum would be subtracted the personal exemptions, plus \$10,000 (an exemption to render the provisions inapplicable to low- and middle-income individuals). The resulting amount would be divided by two to arrive at the minimum taxable income on which the tax would be computed at the regular rates.

ARTIFICIAL LOSS LIMITATIONS: The Limitation of Artificial Accounting Loss proposal is designed to correct some of the inequities associated with tax shelter investments. It is not limited to real estate tax shelters but rather, applies with some variation to all types of tax shelters such as oil and gas, cattle breeding, etc.

The proposal would permit "artificial accounting losses" to be offset only against "related income." With respect to real estate, artificial accounting losses would include all deductible construction-period expenses, as well as the excess of accelerated over straight-line depreciation.

"Related income" for residential real estate would include rental income from all rental properties owned by the investor, not just the rental income from the project that generates the artificial accounting losses as with nonresidential property. Any nondeductible artificial accounting losses will not be lost, but only deferred until such time as the investor has sufficient related income against which such losses can be offset. The proposal as drafted does not specifically apply to subsidized housing, although it is the Treasury Department's intention that such housing will be covered. The proposal does apply, however, to rapid amortization available under Section 167(k) of the Internal Revenue Code, which is used almost exclusively in connection with a Federal, State or local housing assistance program.

If the proposal, is implemented in its present form, the following results are likely: first, rents in projects developed in strong market areas would tend to be somewhat higher than they might otherwise have been; second, the trend toward "retailing" as condominiums units which otherwise would have been rental accommodations would be heightened; third, some "mix and match" syndications (combination of projects that generate a significant cash flow with others, such as subsidized projects, that provide a basis for

artificial accounting losses) would be developed. Existing high cash-flow projects, on which most accelerated depreciation has been used, would tend to become more popular, thus exerting upward pressure on the sales price of such developments.

TAX CREDIT FOR THE ELDERLY: A third Administration proposal, a Property Tax Credit for the Elderly, would allow low- and middle-income homeowners and renters, age 65 or older, a credit against their Federal income taxes where payments of residential real property taxes (or that portion of rent deemed to constitute real property taxes) are excessive in relation to their incomes.

Those eligible could take a credit for the amount of "qualifying real property taxes" in excess of 5 percent of "household income," subject to the limitation that the total credit could not exceed \$500. (Household income would be equal to adjusted gross income, plus unemployment benefit payments, old age or survivors benefit payments under the Social Security Act or the Railroad Retirement Act, and tax-exempt interest on governmental obligations.) However, because "qualifying real property taxes" would not include real property taxes paid on property with respect to which, the taxpayer is receiving a financial subsidy or other benefit under a Federal, State, or local housing program, the beneficiaries of assistance payments under the Section 235 Homeownership Assistance Program, would be unable to utilize the Property Tax Credit for the Elderly.

Elderly persons who rent their homes or apartments would also be allowed a credit for "rent constituting real property taxes" in excess of 5 percent of household income, subject to a maximum credit of \$500.

In general, married individuals could only claim the credit if they filed joint returns. Moreover, welfare recipients would not be eligible for the credit.

This proposal is significant for two reasons: first, it provides direct -- although not equal -- tax relief to both elderly homeowners and renters, in contrast with present law which benefits only homeowners, and, second, the credit provided would be refundable even if a taxpayer's credit exceeds his total tax liability. The Treasury Department estimates that the proposed credit would result in lost revenues of approximately \$500 million a year.

TAXABLE MUNICIPAL BOND ACT: Another proposal presented by the Administration, the Taxable Municipal Bond Act of 1973,

is intended to apply to public housing bonds. However, certain administrative and policy matters as to the application of the proposal to these bonds must be resolved because of the unique nature of the Federal Government's involvement in such obligations.

Under this proposal, the issuer of a qualifying State or local obligation could elect to make its obligations either taxable or tax-exempt. When the issuer chooses to make the obligation taxable, a Federal subsidy would be paid equal to 30 percent of the issuer's annual net interest expense, less the administrative costs to the Treasury Department. Once the choice is made, it is irrevocable. The issuer's allowable expense does not include administrative costs. The base against which the subsidy is computed cannot exceed 10 percent of the principal in any year.

Generally, all tax-exempt obligations are eligible for subsidy except (1) if the interest expense is unreasonably high, (2) if the obligation matures in less than one year, and (3) if "it is held by a Congressionally established entity, owned in whole or in part by the United States, or by a unit which is an issuer of obligations to which Section 103(a)(1) applies."

Should the proposal be extended to public housing bonds, it is not clear whether it would result in actual savings to the Federal Government because of the uncertainty as to the maturity and terms which would be utilized if the proposed option were available. However, according to the Treasury Department, the proposal would be advantageous to an issuer offering maturities beyond 20 years. On such maturities, the spread between the taxable and tax-exempt interest rates is less than 30 percent, and thus the 30 percent subsidy would result in a savings for the issuer.

WELFARE ASSISTANCE PAYMENTS

The Federal Government makes a massive, although indirect, contribution through its welfare programs in determining the housing conditions of millions of poor Americans.

The scope of this indirect intervention in the housing market can only be measured in an approximate way. Estimates by the Department of Health, Education, and Welfare suggest, however, that of the total welfare expenditures in 1972 by State and Federal Governments, approximately \$4.6 billion was used by welfare families for housing. By making further

arbitrary assumptions, it was estimated that of the \$4.6 billion provided to the States by the Federal Government \$2.6 billion was used for housing. This highly approximate figure compares with the \$2.5 billion the Federal Government allotted in the same year to carry out all of its direct housing subsidy programs. Federal welfare assistance, however, is not tied to housing. Federal matching grants are made to State governments which are used to make cash payments to four classifications of low-income people -- the elderly, households with dependent children, the blind, and the disabled. The preceding estimates are based on a review of the two major assistance programs -- Aid to Families with Dependent Children and Old Age Assistance.

It is difficult to measure precisely how much support for housing the Federal Government is providing through welfare assistance expenditures for several reasons. One reason is that the proportion of its cash assistance a welfare family allocates to housing is based largely on its circumstances and priorities, which may bear little relationship to the level prescribed or assumed by the welfare agency. Even where benefits are earmarked for housing, the family may substitute earmarked assistance for income from other sources without changing its total consumption of housing. Another reason is the diversity among the welfare systems of the various States.

In determining a "household needs" budget in setting welfare assistance levels, a housing-cost component is established by the individual States and revised periodically. The extent to which full housing costs are included and earmarked in its welfare payment, if at all, varies widely among States. Some States pay rents up to some ceiling on an "as incurred" basis. Others determine the rent support level on the basis of prevailing rents in a given area. A growing number of States calculate family needs on an overall basis and provide assistance on a "flat grant" basis.

As shown in Table 3, the total monthly welfare allotments vary widely within the States. Under the Aid to Families with Dependent Children program, the highest monthly rental allotment in 1972 was \$162 granted in the State of Connecticut. Only 15 States permitted payments of \$100 or more. Thirteen States plus Puerto Rico, the Virgin Islands and Guam had set a maximum level for housing support at \$50 or below.

TABLE 3

ESTIMATED EXPENDITURES ON HOUSING
THROUGH PUBLIC ASSISTANCE PROGRAMS IN 1972

STATE	AFDC MONTHLY RENT ALLOWANCE	AFDC CASELOAD	AFDC MONTHLY HOUSING COST FOR CASELOAD	OAA MONTHLY RENT ALLOWANCE	OAA CASELOAD	OAA HOUSING COST FOR CASELOAD
ALABAMA	5 19	42,927	5 815,613	540	113,403	54,563,120
ALASKA	140*	4,021	562,940	145	1,307	1,307
ARIZONA	81	18,829	1,525,149	49	13,719	672,231
ARKANSAS	35	21,911	766,885	35	52,245	2,038,575
CALIFORNIA	140	444,865	62,281,100	63	307,748	19,388,124
COLORADO	69	30,580	2,110,020	45	31,137	1,401,165
CONNECTICUT	162	31,853	5,160,186	103	8,288	853,664
DELAWARE	63	7,282	589,766	66	2,987	197,142
DISTRICT OF COLUMBIA	94	26,668	2,506,792	68	4,055	275,740
FLORIDA	81	89,562	7,254,522	50	68,535	3,426,750
GEORGIA	46	96,252	4,427,592	40	91,172	3,663,120
GUAM	20**	610	12,200	20**	479	9,580
HAWAII	157	11,553	1,813,821	59	2,975	175,525
IDAHO	68	6,824	464,032	76	3,405	258,780
ILLINOIS	97	186,019	18,043,643	97	34,202	3,313,594
INDIANA	100	47,680	4,760,800	100	16,005	1,600,500
IOWA	70	24,258	1,698,060	33	21,581	712,173
KANSAS	125	21,068	2,633,500	125	10,251	1,281,375
KENTUCKY	52	41,451	2,155,452	23	57,167	1,314,841
LOUISIANA	22	63,171	1,389,762	35	114,050	3,991,750
MAINE	115	18,408	2,116,920	43	11,017	473,731
MARYLAND	41	57,444	2,355,204	41	9,934	407,294
MASSACHUSETTS	78	81,130	6,328,140	50	58,027	2,301,350
MICHIGAN	145	160,305	23,244,225	145	42,675	6,185,265
MINNESOTA	130	38,510	5,006,300	105	18,116	1,902,180
MISSISSIPPI	50	44,445	2,222,230	50	82,867	4,143,350
MISSOURI	40	64,646	2,585,840	40	93,188	3,727,520
MONTANA	58	6,552	380,036	29	3,029	87,841
NEBRASKA	100	12,021	1,222,400	100	7,255	725,500
NEVADA	58	4,773	276,834	52	3,063	109,270
NEW HAMPSHIRE	85	5,861	498,185	70	4,604	322,280
NEW JERSEY	100	109,919	10,991,900	75	20,497	1,537,275
NEW MEXICO	47	16,187	760,789	37	8,422	311,614
NEW YORK	105	355,491	37,326,555	75	115,428	8,657,100
NORTH CAROLINA	62	47,215	2,927,330	72	35,139	2,530,008
NORTH DAKOTA	72	4,364	314,208	62	4,234	262,508
OHIO	96	130,512	12,529,152	58	50,275	2,915,950
OKLAHOMA	40	30,237	1,209,480	30	66,125	1,983,750
OREGON	54	25,218	1,361,772	42	7,450	312,900
PENNSYLVANIA	86	173,592	14,928,912	65	50,018	3,251,170
PUERTO RICO	20	53,693	1,073,860	20	20,302	466,040
RHODE ISLAND	80	14,051	1,124,080	80	3,997	319,760
SOUTH CAROLINA	40	26,304	1,157,376	35	17,343	607,005
SOUTH DAKOTA	95	6,246	593,370	100	3,723	372,300
TENNESSEE	33	54,666	1,803,978	33	48,852	1,612,116
TEXAS	33	117,971	3,893,043	33	207,000	6,831,000
UTAH	75	12,619	946,425	36	2,823	101,628
VERMONT	104	5,259	546,936	104	4,097	426,088
VIRGIN ISLANDS	16	755	12,000	12	317	3,804
VIRGINIA	95	44,055	4,185,225	95	14,665	1,392,225
WASHINGTON	91	45,097	4,103,827	61	19,251	1,174,311
WEST VIRGINIA	38	20,319	772,122	33	13,013	429,429
WISCONSIN	130	40,097	5,212,610	130	20,257	2,633,410
WYOMING	100	2,052	205,200	65	1,348	87,620
TOTAL (MONTHLY)			275,163,579			108,621,906
TOTAL (ANNUAL)			3,301,962,948			1,303,462,872
TOTAL (BOTH PROGRAMS)						4,605,425,820

* FIGURE NOT REPORTED; IMPUTATION BASED ON CALIFORNIA ESTIMATE SINCE CALIFORNIA NEED STANDARD IS MOST COMPARABLE NEED STANDARD.

** FIGURE NOT REPORTED; IMPUTATION BASED ON PUERTO RICO ESTIMATE, SINCE PUERTO RICO NEED STANDARD IS MOST COMPARABLE NEED STANDARD

SOURCE: DEPARTMENT OF HEALTH EDUCATION AND WELFARE, NATIONAL CENTER FOR SOCIAL STATISTICS

Table 3 also shows the amounts the States allotted for rental payments in 1972. However, there are limitations in collecting the data contained in the table. For example, some States reported the maximum amount allowed for shelter and not what was actually paid out. In the absence of a maximum level, the States reported an average monthly rental component. Also the monthly rental allotment is available for only certain sizes of families. There is not an average for all family sizes. As a result, the housing costs listed under Aid to Families with Dependent Children is derived by multiplying the shelter cost estimate for a family of four by the number of families receiving Aid to Families with Dependent Children. The Old Age Assistance column was derived by multiplying the rent allotment for a one-person household by the number of recipients in the program.

It can be assumed that in the absence of overall welfare assistance from Federal, State and local governments, housing conditions would be much worse for many of the aid recipients. However, it is widely recognized that the levels of total welfare assistance in most cases are not adequate for providing an acceptable standard of living, including safe and sanitary housing.

Where overall welfare levels including housing allotments are low, the recipient is often unable or unwilling to provide a reasonable return to landlords renting standard housing. This inadequate market demand in lower-income areas with high concentrations of welfare recipients is believed to encourage disinvestment in and abandonment of older housing units which may be an important factor in the decay of inner-city housing. Of course, what is true of housing is true of all other items in the family's budget: if the combination of family earnings and assistance payments is not sufficiently high, consumption will suffer.

OTHER FEDERAL POLICIES AFFECTING THE HOUSING MARKET

LABOR POLICY

With the passage of the Davis-Bacon Act in 1931 -- an anti-Depression measure -- the Federal Government embarked on a course that has significantly affected housing construction costs through the years.

The Act established a policy of protecting local wage rates, initially on all Federal construction projects, and later on federally assisted housing construction as well. Today it is applied to almost every major Federal housing

program undertaken by the Government with the exception of one-to-four family units constructed under federally insured or subsidized home mortgages.

The Act requires that wages to laborers on federally financed and supported projects must be at least equal to those "prevailing" in a given jurisdiction. The determination of what constitutes "prevailing" wages is made by the Secretary of Labor. By regulation, his determination is based on wage rates paid to the majority of workers in a given classification in a particular area. If a majority of workers are not paid the same rate, the prevailing rate is that paid to the largest numbers of workers, provided they constitute at least 30 percent of those employed. In the event that less than 30 percent receive the same rate, the average rate is arrived at by adding the hourly rates paid to all workers in a classification and dividing by the total number of such workers.

EQUAL HOUSING OPPORTUNITY POLICY

Over the past decade, the Federal Government has moved through legislative, judicial and executive action toward eliminating racial discrimination in the sale or rental of housing to minority groups, adding a further social objective to housing programs that had been based largely on economic considerations.

Historically, the Federal Government's role in prohibiting discrimination dates back to the Civil Rights Act of 1866, which made purchasing, leasing, inheriting, selling or owning property a right of every citizen. This broad objective, however, was undermined by various discriminatory practices that began developing during the Reconstruction Period -- 1865-1877 -- such as restrictive covenants on land use. These discriminatory practices became so institutionalized during the ensuing three-quarters of a century that the Federal Government in its early housing programs was often found to be perpetuating discrimination by developing projects that were segregated.

The first significant reversal of this pattern came in 1948 when the Supreme Court held that racially restrictive covenants were unconstitutional.⁷ Then, in 1962, President Kennedy, in Executive Order 11063, ordered that the Federal Government:

⁷Shelley v. Kramer, 334 U.S. 1 (1948).

"...take all action necessary and appropriate to prevent discrimination because of race, color, creed or national origin in the sale, leasing rental or other disposition of residential property and related facilities...."

That policy was furthered with the passage of the Civil Rights Act of 1964, Title VI, which prohibits discrimination in any federally assisted program.⁸

The landmark legislation on fair housing for all Americans came in 1968, when Congress went beyond federally assisted housing to outlaw discrimination in the private housing market. Title VIII of the Civil Rights Act of 1968 -- the so-called "fair housing" provision -- bans discrimination in the sale, rental and financing of the vast majority of housing units in the United States. The provision prohibits discrimination in all multifamily housing except one-to-four family dwellings in which the owner occupies a unit and all single-family homes except where the house is sold or rented by the owner-occupant without the use of a real estate broker, provided the house is not advertised in a discriminatory manner.

The provisions of Title VIII allow a person who believes he has been discriminated against to file a complaint with the Secretary of HUD or with comparable State enforcement mechanisms where they exist. The Secretary is charged with the responsibility of investigating and resolving any substantial complaint by eliminating the discriminatory practices through conference, conciliation and persuasion. If he cannot do so, the complainant may file suit in Federal (or in some cases, State) court.

Alternatively, a person who believes that he has been discriminated against may file a civil action directly in Federal court. Additionally, the Attorney General may file a suit in a Federal court if he has reason to believe that there is a pattern or practice of discrimination or that a group of people has been denied its Title VIII rights.

⁸Executive Order 11063 covered federally subsidized or insured housing. The 1964 Civil Rights Act superseded that policy to some extent but did not abrogate Executive Order 11063 which dealt with some matters not covered by the 1964 Act. Federally-insured housing, for example, was specifically excluded from the Act.

Approximately two months following enactment of the 1968 Act, the Supreme Court, based on the 1866 Act, barred racial discrimination in the sale and rental of all property.⁹ Thus, a person who believes that he has been racially discriminated against in a sale or rental transaction involving any type of housing may file suit in a Federal Court without regard to the limitations of Title VIII of the 1968 Act.

Over 1,330 complaints have been filed under Title VI of the 1964 Act and over 7,300 under Title VIII of the 1968 Act. In the last year, the number of complaints has greatly increased as a result of a Government campaign to increase public awareness of Title VIII provisions.

The Department of Justice filed 135 Title VIII suits between January 1969 and June 1973. During the same period, HUD has referred 110 individual Title VIII complaints to the Justice Department with the recommendation that appropriate legal action be taken. Of these, the Justice Department has instituted at least 20 suits, of which one covered 15 individual complaints and a second covered five such complaints.

Also during this same time period, HUD conciliated 1,218 Title VIII complaints. It is anticipated that the number of cases in which conciliation will be attempted will rise considerably due to the use of accelerated processing by which complaints involving multifamily units of 25 or less can be completely investigated and conciliated within two days; increased expertise and number of HUD staff; and other improved management practices.

AFFIRMATIVE ACTION AND PROJECT SITE SELECTION CRITERIA

The 1968 Civil Rights Act, Title VIII, provided that all Executive Departments and Agencies were required to administer their programs and activities relating to housing in an "affirmative" manner so as to further the objective of this Title. This affirmative action provision reinforced the provisions of Title VI of the 1964 Civil Rights Act prohibiting discriminatory actions by the Federal Government.

⁹Jones v. Mayer Co., 392 U.S. 409 (1968).

As a result of the Shannon v. HUD court decision in 1970,¹⁰ HUD in 1972 established criteria aimed at providing minorities with housing opportunities in a wide range of locations in order to open up non-segregated housing opportunities that would contribute to decreasing the effects of past housing discrimination.

The impact of these actions was felt by sponsors of projects who could be disqualified from Federal aid if the project was planned for areas of racial concentration. Through HUD's site selection rating system -- "poor" to "superior" -- priority was given to housing for minorities outside existing areas of racial concentration.

Further implementation of affirmative action objectives came with the establishment of fair housing marketing regulations by HUD in 1972. Under these regulations, a developer was required to market his project in such a manner that it would reach all racial and ethnic groups in the housing market area or face the loss of Federal support.

The new regulations require that: the staff of such a project involved in the rental or sales of such projects be hired on a non-discriminatory basis; fair housing posters be prominently displayed on the site and in the rental and sales office; and printed material and advertising must carry the Equal Housing Opportunity logotype. Finally, each of these actions are to be described in an affirmative marketing plan submitted by the proposing developer at the time of his application for insurance or subsidy.

ENVIRONMENTAL POLICY

In response to the environmental movement of the 1960's, environmental concerns have become an important new factor in Federal housing policies and programs. The Environmental Protection Agency, created in 1970, is the Federal regulatory agency charged with the enforcement of provisions of statutes

¹⁰Shannon et al v. United States Department of Housing and Urban Development, 436 Fed. 2d 809 (1970). In this decision, the court ordered HUD to adopt "some institutionalized method whereby, on considering site selection or type selection (of housing), it has before it the relevant racial and socio-economic information necessary for compliance with its duties under the 1964 and 1968 Civil Rights Acts."

-- such as the Clean Air Act Amendments of 1970 and the Federal Water Pollution Control Act of 1972 -- designed to abate and control pollution. Within its jurisdiction fall control of water pollution, solid wastes, noise and air quality. Its activities in these fields can have an immense impact on the supply, character and location of housing, simply because the Agency influences the timing, character and funding of key municipal facilities required to support housing. In its regulation of regional air, water and solid waste pollution, the Agency requires that States assume increasing responsibility in the broad area of land use decisions, and thereby the location of housing. In addition, legislation now pending in Congress would further define the Federal, State and local roles in other environmental areas such as energy and land use development which impact directly or indirectly upon housing.

Furthermore, The National Environmental Policy Act of 1969 requires all Federal agencies to review and evaluate the impact of their policies and programs on the environment. As interpreted, the impact on social and economic environments, as well as the strictly physical environment, must be considered in governmental decision-making.

In this manner, environmental policies will have a major impact upon the location, design, availability and probably the cost of future housing.

Section 102(2)(C) of the Act defines the requirement for environmental impact statements. Every instrumentality of the Federal Government is required to:

"include in every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on -- (i.) the environmental impact of the proposed action, (ii.) any adverse environmental effects which cannot be avoided should the proposal be implemented, (iii.) alternatives to the proposed action, (iv.) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and (v.) any irreversible and irretrievable commitments of resources which would be involved in the proposed action, should it be implemented."

In response to the Act, HUD's administrative guidelines require that all federally assisted housing by the Department is now subject to five types of environmental reviews:

First, HUD has established two levels of environmental clearance for environmental impact statements. (A) "Normal" clearance must be applied to every project application for insurance or subsidy assistance. This clearance is an assessment of site characteristics, environmental consequences of the proposed development, and a consideration of alternatives with superior environmental consequences. Field checks of sites and surroundings are called for, as well as receipt of comments from local planning agencies, and evidence of local government approval. (B) "Special" environmental clearance is required for all subdivisions of 50 or more lots and for all multifamily projects of 100 or more units, and for projects which are controversial.

Second, in February 1972, HUD issued project selection criteria applying to all proposals for subsidized housing. Environmental considerations were included among the criteria to assure that site locations and site treatment would be appropriate, and adverse environmental impacts of the projects would be avoided. In December 1972, an evaluation of the first several months of performance was published. Data were furnished on environmental matters for 3,001 project proposals. Of these proposals, 972, or 32 percent, received an adequate rating; and only 83 proposals, or 2 percent received poor rating. Of these 83, 37 were deemed to be subject to serious environmental conditions.

Third, on September 1, 1972, noise standards were issued by HUD. They provide measures for estimating the impact of noise on housing sites and include techniques of measurement. Projects not meeting the noise standards cannot be assisted.

Fourth, HUD currently has in review a major revision of the Minimum Property Standards to govern the planning and construction of all HUD-insured and subsidized housing. These proposed new Minimum Property Standards will incorporate environmental quality considerations.

And, fifth, citizens can challenge through court action HUD decisions in relation to environmental policy matters.

The Veterans Administration and the Farmers Home Administration, the other Federal agencies significantly involved in housing, are in the process of preparing administrative guidelines implementing the 1969 Act.

CHAPTER 3

HOUSING FINANCE

INTRODUCTION

This chapter presents an overview of the housing finance market. Its intent is to present the basic determinants of the demand for and supply of housing credit and to show how financial intermediaries direct the flow of funds from individual savers to the purchasers of housing. The activities of the Government in the housing finance market are described and related to the basic determinants of supply and demand.

A general survey of the housing finance market reveals the following significant characteristics and trends.

- The housing finance market is one of the largest users of borrowed funds in the Nation.
- Financial institutions which obtain loanable funds from savings deposits have been the major source of residential credit over the past generation.
- The supply of residential mortgage funds has been subject to significant volatility over time.
- Government-sponsored second-layer lenders have constituted a significant source of housing credit during several recent periods of credit stringency.
- An increase in the liquidity and marketability of mortgages in recent years appears to have affected their yields and investment characteristics.
- The demand for credit to finance multifamily units has risen sharply over the past five years.

Two areas of particular interest covered in this chapter concern the efforts of Government and Government-sponsored agencies to moderate short-run fluctuations in the supply of mortgage credit and to affect the long-run values of the mortgage interest rate and the quantity of mortgage credit outstanding. In this regard there is an important distinction to be made between short-run fluctuations and the long-run values of mortgage market variables. It will be

argued in this chapter that the activities of Government-sponsored agencies can have significant short-run impacts on the mortgage market and residential construction activity while having somewhat less effect on the long-run values of the mortgage rate, mortgage stock, and housing stock.

Monetary phenomena play a particularly important role in the market for housing finance. There exist different opinions as to whether monetary forces significantly affect total consumption or investment, and individuals differ in their views concerning the efficacy of monetary policy as opposed to fiscal policy. However, there is a consensus that monetary forces have a powerful and pervasive effect on residential construction activity through the markets for savings deposits, mortgages, and residential construction. This monetary impact operates through both the cost-of-capital (interest-rate) and credit rationing (availability-of-credit) channels, where the credit rationing effect is particularly important.

Credit rationing by mortgage-lending institutions is often observed when stringent credit conditions lead to a reduction in the volume of mortgage lending. Under such conditions the mortgage rate rises but generally not fast enough to provide quickly a market-clearing price. That is, the mortgage market becomes supply-constrained, and there is a shortage of credit in the sense that the quantity demanded exceeds the quantity supplied at the prevailing mortgage rate. It is during these periods of credit rationing that Government-sponsored credit agencies have their largest impact as they act to increase the supply of mortgage credit and reduce the degree of credit rationing.

In the longer run, the efforts of the Government-sponsored credit agencies to increase mortgage flows and lower mortgage interest rates are likely to be somewhat less effective. As the actions of these institutions begin to lower mortgage interest rates, private investors, finding that mortgages are becoming less desirable investments, may shift their funds to non-mortgage securities. Hence, any increase in the mortgage credit flow from Government-sponsored institutions may to some degree be offset by reductions in private lending.

When long-run mortgage credit flows are increased by Government policies, housing investments will, of course, be easier to finance and the quantity of housing

purchased will rise. However, the increase in housing investments is likely to be somewhat smaller than the increase in mortgage credit flows, because potential owners will also find it easier to carry a higher loan-to-value ratio. In effect, some of the increased mortgage borrowing, using the home as collateral, allows the buyer to use less of his total assets for a downpayment and gives him more freedom to buy other things. It may also lessen the need for non-mortgage borrowing to finance purchase of consumer goods and other assets. For example, individuals often refinance their homes to provide resources to buy a college education for their children or to meet other non-housing needs.

Government actions have had some lasting effects where they have changed the characteristics of the mortgage investment or the nature of the market place. Specifically, Government has reduced the risk of investing in mortgages by providing mortgage insurance and pooling risks into mortgage-backed securities. In addition it has encouraged the development of private secondary markets and facilitated the flow of funds between geographically-isolated markets. As Government continues to improve the efficiency of the mortgage market and demonstrates the viability of new innovations, its power to have a further influence on the mortgage market will be correspondingly reduced.

The improved efficiency of the mortgage market is revealed by the fact that the gross yield advantage of residential mortgage loans over alternative long-term investments -- such as corporate bonds -- has fallen over the past two decades. The gross yield-spread between residential mortgage loans and newly-issued corporate bonds fell from an average of over 150 basis points during the period 1955-1960 to an average of less than 50 basis points during the period 1970-1972. During most of 1970 the conventional mortgage rate was below the corporate bond rate on new issues. The gross yield-spread between residential mortgage loans and newly-issued corporate bonds has been below 100 basis points since 1966, and since 1969 it has generally been less than 50 basis points. Therefore, residential mortgage loans have lost much of their gross yield advantage over alternative long-term investments over the past two decades.

The plan of this chapter is as follows. The first section presents a general overview of the housing finance market. First, a brief description of the magnitude and composition of the outstanding residential mortgage debt is provided. Then, the housing finance market in the short and long runs is described. The second section presents various mortgage debt instruments which have either been used or proposed for use in housing finance. The Appendix describes in detail the various agencies and institutions which participate in the housing finance market.

OVERVIEW OF HOUSING FINANCE MARKET

Since the end of World War II the housing market has been one of the largest users of borrowed funds in the American economy. Between 1947 and 1971 the total net public and private debt outstanding in the United States rose from \$415.7 billion to \$1,996.4 billion -- an increase of \$1,580.7 billion or 380 percent. During this same period residential mortgage debt outstanding on nonfarm properties rose from \$34.8 billion to \$374.6 billion -- an increase of \$339.8 billion or 976 percent. By comparison, private corporate debt outstanding increased by 660 percent during this same period as it rose from \$108.9 billion to \$827.3 billion. Overall, the increase in nonfarm residential mortgage debt accounted for 21 percent of the increase in total outstanding net debt.¹

Reported mortgage debt outstanding on residential properties at the end of the fourth quarter of 1972 was \$383.1 billion. Of this total, \$327.9 billion, or 85.6 percent of the total, represented loans held by four types of financial institutions: commercial banks, life insurance companies, mutual savings banks, and savings and loan associations. Savings and loan associations alone supplied more than 45 percent of this outstanding residential mortgage debt.

Table 1 presents holdings of land, construction, and long-term mortgage loans by type of property, financing and lender. Charts 1 and 2 utilize data from Table 1 to illustrate the composition of construction and long-term mortgage loans by type of lender. Although the data on residential loans clearly illustrate

¹Council of Economic Advisers, Economic Report of the President, Washington, D.C.: Government Printing Office, 1973, pp. 264 and 266.

TABLE 1

REPORTED HOLDINGS OF LAND, CONSTRUCTION AND LONG-TERM MORTGAGE LOANS, BY TYPE OF PROPERTY,
FINANCING, AND LENDER, END OF FOURTH QUARTER, 1972

(IN MILLIONS OF DOLLARS)

PROPERTY TYPE	COMMERCIAL BANKS (1)	MUTUAL SAVINGS BANKS (2)	SAVINGS & LOAN ASSOC. (3)	LIFE INSURANCE COMPANIES (4)	NON-INSURED PENSION FUNDS (5)	MORTGAGE INVESTMENT TRUSTS (6)	STATE & LOCAL RETIREMENT FUNDS (7)	FEDERAL CREDIT AGENCIES (8)	GNMA POOLS FHDA BLOCKS OF LOANS (9)	STATE & LOCAL CREDIT AGENCIES (10)	TOTAL FOR GROUPS SHOWN (11)
CONSTRUCTION LOANS											
1-4 FAMILY HOMES	\$ 4,243	\$ 263	\$ 5,307	\$ 7	\$ 0	\$ 576	\$ 16	\$ 0	\$ 0	\$ 22	\$ 10,433
MULTI-FAMILY	2,800	585	3,998	38	0	2,809	22	89	0	811	11,152
NON-RESIDENTIAL	5,565	320	1,874	351	1	2,332	0	17	0	1	10,462
FARM PROPERTIES	63	*	8	14	0	0	0	0	0	0	85
TOTAL CONSTRUCTION LOANS	12,671	1,167	11,187	410	1	5,717	38	106	0	834	32,132
LONG-TERM MORTGAGE LOANS											
1-4 FAMILY HOMES											
FHA INSURED	7,236	14,955	13,340	8,391	545	61	1,780	15,477	3,857	374	66,016
VA GUARANTEED	3,182	12,772	11,971	4,646	258	130	736	6,182	1,496	35	41,406
CONVENTIONAL	40,815	19,901	135,489	8,374	263	188	384	3,575	4,801	2,089	215,878
SUBTOTAL	51,233	47,627	160,800	21,411	1,066	378	2,900	25,235	10,154	2,497	323,301
MULTI-FAMILY											
FHA INSURED	379	1,528	680	1,553	183	1	1,695	4,643	151	354	11,167
CONVENTIONAL	2,176	8,367	17,037	15,147	366	518	535	1,933	130	2,421	48,630
SUBTOTAL	2,555	9,895	17,717	16,700	550	518	2,230	6,576	281	2,775	59,797
NON-RESIDENTIAL	25,362	10,217	14,243	30,657	1,059	1,579	1,011	3,187	98	649	88,063
FARM PROPERTIES	4,689	41	548	5,629	24	4	160	9,385	2,483	425	23,387
TOTAL LONG-TERM MORTGAGE LOANS	83,838	67,781	193,308	74,397	2,699	2,480	6,301	44,383	13,015	6,345	494,548
LAND LOANS											
	2,577	228	1,745	305	28	1,966	11	*	0	0	6,859
TOTAL MORTGAGE LOANS	99,086	67,176	206,241	75,112	2,728	10,162	6,350	44,489	13,015	7,179	533,539

NOTE: SUM OF COMPONENTS MAY NOT EQUAL TOTALS DUE TO ROUNDING.

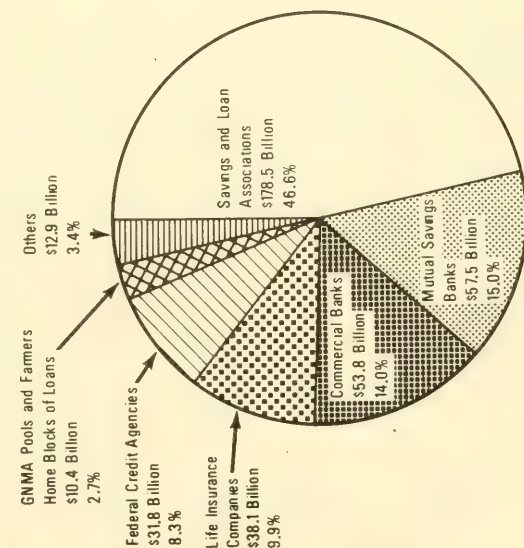
*MEANS LESS THAN \$500,000.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, SURVEY OF MORTGAGE LENDING ACTIVITY.

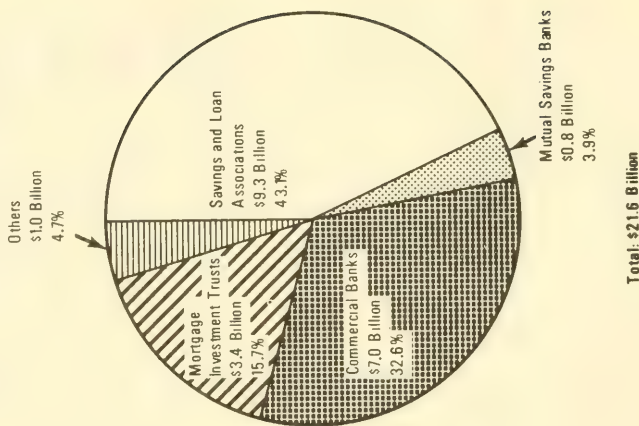
CHART 1

REPORTED HOLDINGS OF RESIDENTIAL MORTGAGE AND CONSTRUCTION LOANS BY TYPE OF LENDER, END OF FOURTH QUARTER, 1972

RESIDENTIAL MORTGAGE LOANS OUTSTANDING
BY TYPE OF LENDER, END OF FOURTH QUARTER, 1972

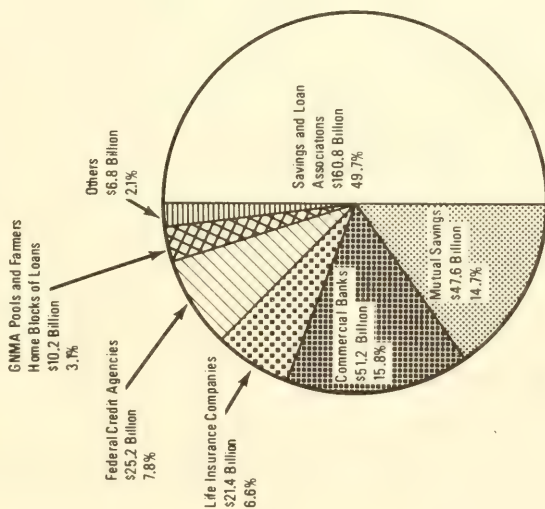


RESIDENTIAL CONSTRUCTION LOANS OUTSTANDING
BY TYPE OF LENDER, END OF FOURTH QUARTER, 1972

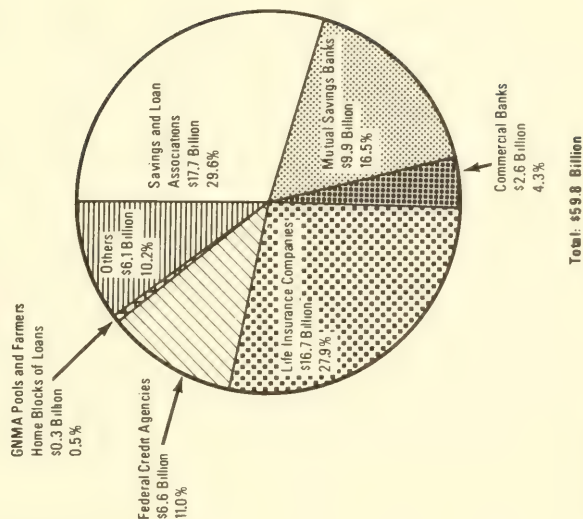


REPORTED HOLDINGS OF RESIDENTIAL MORTGAGE LOANS BY TYPE OF PROPERTY AND LENDER, END OF FOURTH QUARTER, 1972

**MORTGAGE LOANS OUTSTANDING ON ONE-TO-FOUR-FAMILY HOMES
BY TYPE OF LENDER, END OF FOURTH QUARTER, 1972**



**MORTGAGE LOANS OUTSTANDING ON MULTI-FAMILY UNITS
BY TYPE OF LENDER, END OF FOURTH QUARTER, 1972**



that housing in the United States is financed predominantly by funds obtained from four types of private financial institutions, the lending activities of these private institutions are supplemented and complemented by several private and public agencies in the field of housing finance.

SHORT RUN PROBLEMS IN HOUSING FINANCE

The residential construction industry has earned the reputation for being one of the more cyclical sectors of the economy. The cycles tend to be well defined and of considerable magnitude. During the 1960's, there were three major declines in the value of new private housing construction put in place. Between calendar 1959 and 1961, this amount fell 11.2 percent; between 1964 and 1967, the fall was 13.3 percent; and between 1969 and 1970 the fall was 9.4 percent. In all of these periods, the value of total new non-residential construction continued to rise, showing the relative instability of residential construction.²

There is general agreement that the primary determinant of this cyclical pattern is the supply of mortgage credit. The supply of credit made available to the homebuyer originates from the savings of individuals and corporations and is also partly determined by various governmental policies. These savings are passed from the saver to the homebuyer by a large number of private and government financial intermediaries. The bulk of the funds for residential mortgage credit passes through four types of private financial institutions: savings and loan associations, mutual savings banks, commercial banks, and life insurance companies. The savings and loan associations and the mutual savings banks are often referred to collectively as thrift institutions. Thrift institutions and commercial banks are depository institutions which held almost three-fourths of the total residential mortgage debt outstanding in 1972. The fourth major supplier of residential mortgage funds -- the life insurance companies -- obtains funds from holders of life insurance policies. Therefore, the bulk of the funds for the extension of residential mortgage

²Ibid., p 236. Of course, housing is not the only cyclical industry. For example, the automobile and machine tool industries experience fluctuations that are sometimes even more severe.

credit comes from private financial institutions which invest the savings of predominantly low- and middle-income individuals.

The four major types of mortgage lending institutions and Real Estate Investment Trusts supply the bulk of short-term funds to the residential construction industry. At the end of 1972 these financial institutions were holding \$20.6 billion in construction loans for residential housing units.

Commercial banks and life insurance companies have numerous investment opportunities and hold mortgages as one of many assets. These financial institutions select and arrange their portfolio on the basis of the return and risks attached to various assets. Therefore, mortgages must compete with numerous other assets for a place in lenders' portfolios, and the expected return and risk associated with mortgages are compared with the expected returns and risks associated with competing assets when managers of portfolios make their investment decisions.

Savings and loan associations and mutual savings banks are the most highly specialized of private mortgage lending financial institutions. The high percentage of mortgages in their portfolios is primarily due to their history as specialists in housing finance, government restrictions on their ability to invest in consumer and most business loans, and the favorable tax treatment which they receive for additions to their bad-debt reserves to back their mortgage holdings. Savings and loan associations typically hold more than 75 percent of their assets in residential mortgages and held 46.4 percent of the outstanding residential mortgage debt in 1972.

Credit flows into housing tend to vary greatly over the business cycle because of the structure and regulation of the major mortgage lending institutions. Thrift institutions and commercial banks are hampered in their ability to maintain a steady flow of funds into housing finance because of the deposit interest rate ceilings set by various regulatory agencies. In addition, the asset liability structures of the thrift institutions would tend to reduce their ability to compete effectively for funds when market interest rates rise, even if there were no deposit rate ceilings.

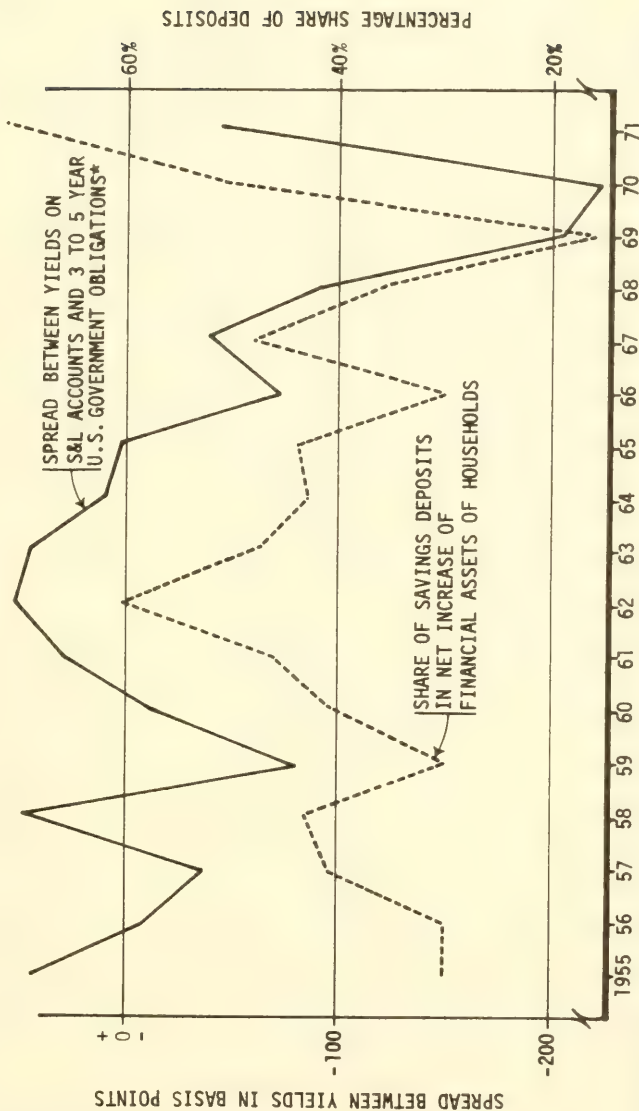
The asset/liability structures of thrift institutions are characterized by long-term assets and short-term liabilities. The assets of thrift institutions consist mostly of mortgages which have an average maturity of 10 years while their liabilities consist of savings deposits which are, for the most part, payable on demand. The problems created by this method of financial intermediation become particularly acute during periods of rising interest rates. When interest rates rise, thrift institutions must offer higher rates on their deposits to prevent depositors from removing their funds to purchase other higher-yielding financial assets. However, the deposit interest rate which a thrift institution can afford to pay is limited by the effective yield of the long-term assets purchased in periods of lower interest rates which comprise the bulk of their asset portfolios.

As a result of the deposit rate ceilings and the asset/liability maturity dichotomy, the deposits of thrift institutions are unable to compete with other financial assets during periods of rising interest rates; hence, thrift institutions tend to lose funds as their depositors take advantage of higher interest rates on other financial assets. This loss of deposits forces thrift institutions to curtail their mortgage lending, and housing production suffers accordingly.

The success of savings and loan institutions in attracting deposits during different time periods can be measured by the extent to which individuals choose to hold net increases in their total stock of financial assets in the form of savings deposits. Chart 3 examines the share of net additions to the financial assets of households going into savings deposits and shows that this share varies directly with the difference (spread) between interest on savings deposits and the rate on Government securities. The percentage share of savings deposits in the net additions to the financial assets held by households fell dramatically in 1959, 1966 and 1969 as market interest rates rose relative to the interest rates paid on savings deposits.

Financial intermediaries other than thrift institutions also tend to decrease their volume of mortgage lending during periods of rising interest rates and credit stringency. Mortgage rates tend to respond sluggishly to current financial conditions and rise proportionally less than other interest rates. In many states the situation is exacerbated by usury laws. As

SHARE OF SAVINGS DEPOSITS IN NET INCREASE OF FINANCIAL ASSETS OF HOUSEHOLDS AND SPREAD BETWEEN YIELDS ON S&L ACCOUNTS AND 3 TO 5 YEAR U. S. GOVERNMENT OBLIGATIONS 1955 - 1971



* POSITIVE SPREAD INDICATES YIELD ON S&L ACCOUNTS IS ABOVE YIELD ON 3 TO 5 YEAR U.S. GOVERNMENT OBLIGATIONS.
SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM THE
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND THE FEDERAL HOME LOAN BANK BOARD.

market interest rates rise, lenders tend to decrease their volume of mortgage lending and purchase other financial assets whose yields gain in attractiveness relative to those on mortgages. This is particularly true of life insurance companies and commercial banks which have a great deal of freedom in choosing the type of financial assets to hold in their portfolios.

In summary, the decline in residential construction activity during periods of rising interest rates is primarily attributable to four factors. First, thrift institutions get trapped by their asset/liability structure and have difficulty in retaining and attracting deposits to provide funds for mortgage lending. Second, ceilings on deposit interest rates prevent them from competing for funds, even in those instances when they could afford to raise rates. Third, other financial institutions decrease their volume of mortgage lending and shift into higher yielding securities as their rates rise relative to the mortgage rate. Fourth, effective State-imposed usury ceilings on mortgage rates intensify the shift out of mortgages and into other financial assets.

GOVERNMENT PROGRAMS TO REDUCE THE SHORT-RUN FLUCTUATIONS IN HOUSING FINANCE

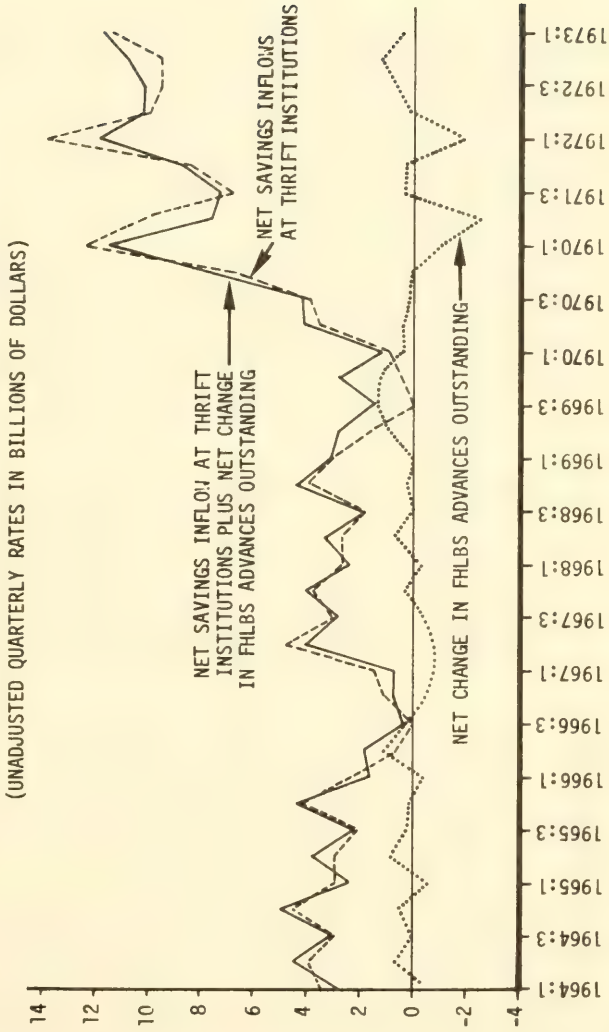
Recognizing that periods of rising interest rates and credit stringency have a severe impact on residential housing production, the Government has taken a number of steps over time in an effort to moderate the cyclical fluctuations in mortgage credit availability.

The Government sponsors or operates several institutions and agencies which are essentially financial intermediaries whose purpose it is to channel additional funds into housing whenever financial conditions threaten to reduce the volume of mortgage credit significantly.

The Federal Home Loan Bank System was established in part to counter the cyclical variations in housing credit availability. By making advances or short-term loans to member savings and loan associations when deposits were falling, it has had some success in stabilizing credit flows to mortgage markets.

Chart 4 provides some indication of the success of the Federal Home Loan Bank System in attempting to smooth out the supply of funds available to savings and loan associations. During the tight credit conditions of 1969

NET QUARTERLY FEDERAL HOME LOAN BANK SYSTEM ADVANCES AND SAVINGS INFLOWS AT THRIFT INSTITUTIONS, 1964 THROUGH FIRST QUARTER 1973



3-13

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM THE FEDERAL HOME LOAN BOARD AND THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS.

a significant amount of funds was provided during a period in which net-savings inflows fell virtually to zero. Also, a less serious trough in savings flows was smoothed out in 1972.

To finance these advances the Federal Home Loan Bank System must sell its consolidated debentures in the Nation's securities markets. During periods of tight credit such issues intensify interest rate pressures by competing with other borrowers for credit. However, this is one of the functions of the Federal Home Loan Bank System -- to insure that the effects of tight money are spread to all sectors of the economy and do not fall disproportionately on housing. Of course, this does not mean that the System attempts to totally insulate the housing sector from the need to cut back spending during inflationary periods. In fact, Federal Home Loan Bank System activities will not have this effect because the interest rate charged on advances reflects the cost of funds to the Federal Home Loan Bank System, and during periods of tight money savings and loan borrowing and, in turn, their lending to homebuyers will be restricted by the higher interest rates.

The Federal National Mortgage Association plays a similar role by purchasing federally underwritten mortgages and, more recently, conventional mortgages in order to moderate the decline in housing production which occurs during periods of credit stringency. During the tight credit conditions of 1966 the Federal National Mortgage Association made net purchases of slightly over \$2 billion in mortgages while during a similar period in 1969 it made net purchases of over \$4 billion.

The Federal Home Loan Mortgage Corporation was established in 1970 with the authority to purchase conventional mortgages from savings and loan associations in order to improve the liquidity of their mortgage portfolios. Thus far, its mortgage purchases have been small relative to the size of the market and the level of purchases made by the Federal National Mortgage Association.

While the activities of these institutions provide general support to the mortgage market, another institution, the Government National Mortgage Association, has used its resources during periods of tight monetary conditions to maintain the flow of mortgage credit to lower income borrowers specifically. In 1971 the Government National Mortgage Association offered commitments to

purchase FHA-insured mortgages valued under \$22,000 per housing unit, bearing interest rates below the market rate in order to provide lower borrowing costs to a previously unsubsidized class of borrowers. From August to December of 1971, the Government National Mortgage Association offered commitments to purchase \$2.4 billion of these mortgages or about 40 percent of the FHA mortgages originated during this period. The price offered for the mortgages implied an interest rate of 7.55 percent at a time that the FHA market rate was 7.9 percent. In other words, the Government National Mortgage Association subsidized borrowers and absorbed the differential when it resold the mortgages to the Federal National Mortgage Association.

In recent years the Government has attempted to reduce the ability of depositors to transfer their funds from depository institutions to other financial assets. In 1970 the Department of the Treasury raised the minimum denominations of Treasury bills to \$10,000 (notes and bonds are still \$1,000). Government-sponsored institutions have also raised their minimum denominations to \$15,000. These actions keep small savers from taking advantage of the returns on these instruments, since they do not have the requisite level of funds to shift into Treasury bills and such other higher yielding assets.

Although these institutions and policies have had some effect in moderating the wide fluctuations in the supply of mortgage funds, the most recent experience indicates that the availability of credit for housing finance is still subject to fluctuations caused by variations in the flow of funds to depository institutions.

Recognizing that much of the instability in mortgage credit markets is a result of the regulatory environment in which the mortgage-lending institutions operate, the President's recent Recommendations for Change in the United States Financial System attempts to improve this situation by fundamentally altering their regulatory framework. It is recommended that thrift institutions be given much more flexibility in investing their funds. They would be allowed to make a limited number of consumer loans, real estate loans under the same conditions as commercial banks, construction loans not tied to permanent financing, and community rehabilitation loans. They would also be allowed to expand their services to depositors by offering Negotiable Order of Withdrawal (NOW) accounts. These recommendations would make them potentially less susceptible to periods of

credit stringency and they would lessen the need for the protection afforded by interest rate ceilings. Therefore, the interest rate ceilings on time and savings deposits at commercial banks and thrift institutions would gradually be phased out.

MORTGAGE MARKETS IN THE LONG-RUN

Since the 1930's, the Federal Government has adopted a number of programs in an attempt to increase the flow of credit into mortgages in the long run. These actions can be divided into three broad categories:

- . Programs which attempt to make the mortgage investment more attractive by reducing the risk to the private mortgagee;
- . Direct lending and net purchases of mortgages by Government and Government-sponsored institutions; and
- . Tax advantages provided to certain categories of investors in mortgages.

POLICIES WHICH REDUCE RISK: Two types of risk are taken in mortgage investment. First, there is the risk that the borrower will default. Second, there is the risk that the lender will suffer a capital loss if he must sell the mortgage.

The insurance and guarantee programs of the FHA, Farmers Home Administration (FmHA) and the VA allow the mortgage lender to acquire protection against losses resulting from defaults. These programs are described in detail in the Appendix.

By reducing risk, such insurance or guarantee programs induce lenders to invest more in the mortgages which benefit from the program. Thus, the reduction of risk enables homebuyers to obtain more favorable credit terms with federally-underwritten mortgages.

Because FHA, FmHA, and VA serve only part of the mortgage market, a large portion of the funds which they attract will be drawn away from other parts of the mortgage market while the rest will be drawn from other security markets. In other words, most of the lending which is insured or guaranteed does not represent new mortgage lending, but only reflects a redistribution of funds from conventional

mortgages to insured and guaranteed loans. The programs are, in fact, explicitly designed to help particular groups in the population through this redistribution -- primarily buyers in the middle- and lower-income groups.

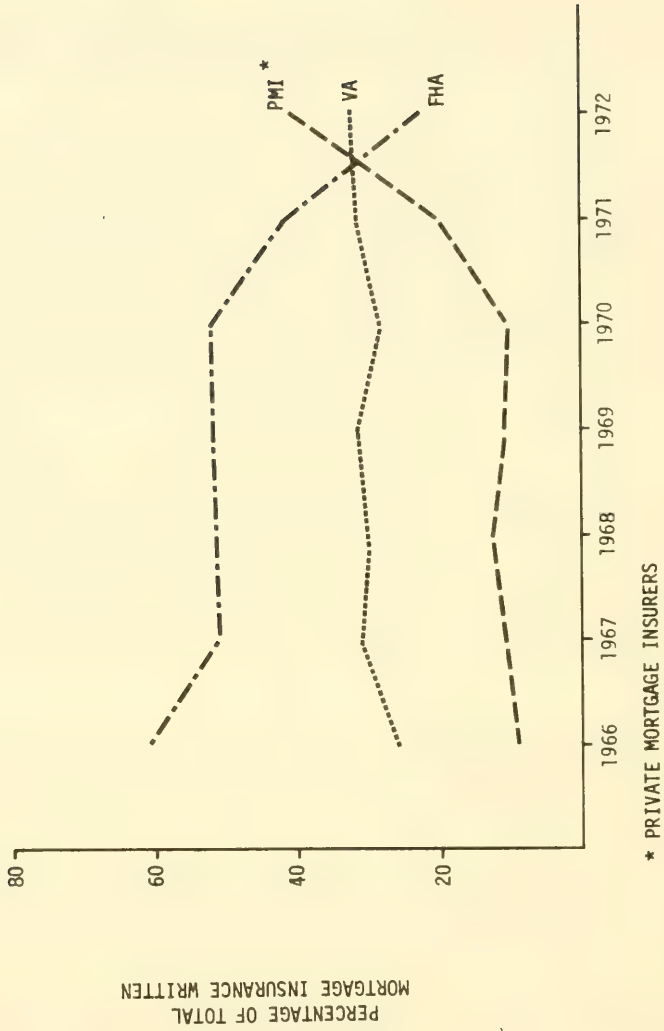
The FHA and VA have provided other benefits to mortgage markets in addition to making the mortgage a more attractive investment. These agencies pioneered the use of the long-term, low downpayment mortgage and demonstrated the usefulness of the instrument. In addition, they demonstrated that the provision of mortgage insurance for middle-income groups can be self-financing, and thus paved the way for the recent expansion of private mortgage insurers. Chart 5 illustrates the share of the mortgage insurance market covered by private mortgage insurers, FHA, and VA. In 1972, for the first time since the Great Depression, private mortgage insurers issued more insurance than did either FHA or VA.

Another important form of insurance is that provided to depositors by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. These programs protect depositors in thrift institutions against the possibility that their financial institution will experience a rash of defaults and be unable to repay their deposits. Hence, deposits in lending institutions become more attractive, and these institutions have a larger base for their lending activities than would exist in the absence of deposit insurance.

Even if a mortgage is free of default risk to the lender, the mortgage holder accepts the risk that he will experience a capital loss when interest rates are higher than those prevailing when he made the loan. As noted above Government and Government-sponsored institutions undertake actions which attempt to stabilize mortgage flows. These actions tend to smooth out short-run fluctuations in mortgage interest rates and, by implication, mortgage prices. This reduction in mortgage price variability makes mortgages less risky as investments.

Government-sponsored institutions are also playing an important role in broadening the market for mortgages, and this reduces the risk of capital loss on resale. If there is not a well-organized market place for mortgages with regularly quoted prices, a mortgage investor may find that he must artificially lower the price to find a buyer thus adding to the risk of holding mortgages. If there is a well-organized, deep market with quoted prices

CHART 5
MARKET SHARES OF MORTGAGE INSURERS
1966 - 1972



the seller may still take a capital loss because of a rise in interest rates, but at least he knows that his decision to sell will not, itself, drive down the mortgage price significantly.

It is also important that the market be national in scope. When local markets are isolated from national markets, mortgage lenders are not able to diversify against local recessions.

The creation of Federal National Mortgage Association (FNMA) in the 1930's was intended to aid the establishment of a deep, national, secondary market for FHA mortgages. Precisely defined, a secondary market is a resale market where completed mortgages are bought and sold. However, the present FNMA is best described as a financial intermediary which attracts funds by selling bonds and notes and uses these funds to purchase mortgages for its own portfolio. The pre-1966 FNMA not only purchased but also sold a relatively large portion of its mortgages as Table 2 illustrates. But the post-1966 FNMA has sold fewer mortgages relative to its purchases. During the period 1955-1965, the FNMA made net purchases of \$3.6 billion, whereas it made net purchases of \$21.3 billion during the period 1966-1972. Today, FNMA is the largest single financial intermediary serving the mortgage market. Its size is illustrated by the fact that FNMA's purchases in 1970 absorbed about one-third of all FHA- and VA-backed mortgages originated in that year. Although FNMA has evolved from a pure secondary market institution into a financial intermediary, it must be emphasized that it still plays an important role in deepening the FHA-VA mortgage market and making it national in scope. Since 1970, it has also had the authority to buy conventional mortgages, although it has continued to concentrate its activity in the FHA-VA market.

In 1970, the Federal Home Loan Mortgage Corporation, owned by The Federal Home Loan District Banks, was created to broaden the market for conventional mortgages. It has been working actively with the FNMA to develop a private secondary market where investors can meet to buy and sell completed mortgages. To facilitate this goal, the Federal Home Loan Mortgage Corporation has taken a number of steps to enhance the attractiveness of mortgage instruments and to improve the market in which they are traded. These steps include:

- . The development of a uniform format for mortgage documents which would enable .

TABLE 2
FEDERAL NATIONAL MORTGAGE ASSOCIATION ACTIVITY
1955 - 1972

(DOLLARS IN MILLIONS)

YEAR	MORTGAGE TRANSACTIONS DURING PERIOD			MORTGAGE HOLDINGS (YEAR-END)
	PURCHASES	SALES	NET PURCHASES	
1955	\$86	\$0	\$86	\$86
1956	575	5	570	649
1957	1,021	3	1,018	1,636
1958	260	466	-206	1,381
1959	735	4	731	2,050
1960	980	42	938	2,903
1961	624	522	102	2,872
1962	548	391	157	2,847
1963	181	780	-599	2,062
1964	198	78	120	1,997
1965	757	46	711	2,520
1966	2,081	*	2,081	4,396
1967	1,400	12	1,388	5,522
1968	1,944	0	1,944	7,167
1969	4,121	0	4,121	10,950
1970	5,078	0	5,078	15,502
1971	3,574	336	3,238	17,891
1972	3,699	213	3,486	19,891

* LESS THAN \$500 THOUSAND

NOTE: ALL DATA ADJUSTED TO EXCLUDE SPECIAL ASSISTANCE AND MANAGEMENT AND LIQUIDATION FUNCTIONS TRANSFERRED TO THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION IN 1968.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM THE FEDERAL NATIONAL MORTGAGE ASSOCIATION.

private investors to easily assess the quality of the mortgages being offered for sale.

- . Weekly publication in the "Wall Street Journal" of yields on FHA and conventional single-family mortgage loans sold in the secondary market.
- . The introduction, together with FNMA, of a uniform mortgage document for each state in an effort to eliminate the different forms used in many states.
- . Testing the feasibility of establishing an automated trading information system for the secondary market for both Government-insured or -guaranteed securities and conventional mortgages. Such a system would operate along the lines of the over-the-counter securities market. Interested market participants would have access to a terminal that would provide them with the necessary information to make a transaction, such as yields, value, maturity, and type and location of the property secured by the mortgages being offered for sale. If a mortgage holder desired to sell some of his holdings, he would make the offer through this network to potential buyers all over the country. Likewise, interested buyers could easily find out what mortgages were being offered for sale. Such a system would facilitate the flow of information and greatly improve the secondary market.

While Government-sponsored institutions are playing an important role in perfecting mortgage markets, the private secondary market is already quite significant and still growing in size. Approximately 22 percent of the 1971 volume of \$14 billion and 34 percent of the 1972 volume of \$18 billion of private secondary mortgage market purchases of one-to-four family home loans represented loans that were neither insured nor guaranteed by the Government or Government-sponsored agency. These transactions took place primarily between mortgage bankers, savings and loan associations, mutual savings banks and life insurance companies.

DIRECT LENDING AND NET PURCHASES OF MORTGAGES BY GOVERNMENT-SPONSORED INSTITUTIONS: With the exception of a small VA program, the Government has not engaged in direct lending for mortgages.³ However, as shown in Table 2 FNMA has engaged in significant net purchases of mortgages in the secondary market since 1966. These are financed primarily by mortgage repayments and the issuance of debentures and other obligations.

The effectiveness of net purchases in driving down mortgage interest rates is limited in the long run. In the short-run, FNMA purchases definitely drive down mortgage interest rates and increase the supply of mortgage credit. However, as mortgage interest rates fall, the evidence suggests that other mortgage lenders begin to find mortgages less attractive, and they begin to shift to other securities. This shift occurs with a time lag. In other words, the long run impact of FNMA purchases is less significant than the short run impact. While FNMA attracts funds to mortgages from new investors, the effects are likely to be offset somewhat in the long run as other sources of mortgage funds seek out new investment opportunities.⁴

The same long-run phenomenon also applies to the programs operated by Government National Mortgage Association and the Farmers Home Administration. By pooling mortgages and selling mortgage-backed bonds, these institutions significantly increase the supply of funds available for mortgages in the short run. But like the FNMA's purchase programs, these actions tend to reduce the mortgage interest rate; thus, in the long run some private lenders may shift out of the mortgages and into higher yielding securities.

TAX ADVANTAGES: In the past, thrift institutions were permitted allowances for bad debt reserves provided that a certain percentage of their investment portfolio was in

³The Farmer's Home Administration temporarily makes a direct loan when it originates a mortgage, but notes or securities on the loan are soon sold to other investors.

⁴For an analysis of the FNMA's impact on the mortgage market, see Dwight M. Jaffee, "An Econometric Model of the Mortgage Market," published in Savings Deposits, Mortgages, and Housing, edited by Edward M. Granlech and Dwight Jaffee, Lexington Books, Lexington, Mass., 1972, p. 171.

mortgage investments. This undoubtedly increased their mortgage lending to levels greater than would otherwise occur, and thus imposed downward pressures on mortgage interest rates. Again, it must be noted that the resulting increase in mortgage lending by the thrift institutions cannot be considered a net addition to the total supply of mortgage funds, since some lenders, without the tax advantage, will have been driven out of the mortgage market by the slightly lower rates. In 1969, this tax advantage was significantly decreased, but the President has recently proposed active consideration of a new tax credit for all mortgage investors.

The President's tax proposal would allow an individual investor or financial institution a tax credit on income earned from mortgage investments. The size of the tax credit would decline as the portion of mortgages in the investor's portfolio declined. By effectively increasing the after-tax yield on mortgages, mortgages would become more attractive investments and lenders would be encouraged to increase the supply of funds for housing production and homeownership.

The fact that mortgage interest payments are deductible from adjusted gross income for tax purposes lowers after-tax interest costs to borrowers, thereby stimulating the demand for mortgage borrowing and increasing the flow of mortgage funds. This deduction was discussed in detail in Chapter 2.

MORTGAGE DEBT INSTRUMENTS

The mortgage debt instrument agreed upon by the borrower and lender to define their contractual agreement is an important element in the process of housing finance. The instrument typically defines the method for repayment of principal and interest. The borrower and lender then negotiate such terms as the length and size of the loan and the interest rate. Individualized contracts can be negotiated without the use of a standard, printed mortgage debt instrument, but this procedure is too involved and costly for most contractual negotiations and is used only in atypical situations where the available standard mortgage debt instruments fail to provide a contractual arrangement which adequately serves the interests of both borrower and lender.

There are certain advantages to limiting the number of repayment methods available to borrowers and lenders. It is easier for the borrower and lender to become familiar

with the terms and implications of each method; transaction costs are reduced due to the limited number of options available; and secondary market operations are facilitated where there are large volumes of a limited number of mortgage types. Uniformity has an important effect upon the marketability of financial instruments, and too many variations of mortgages can impair the development of the secondary mortgage market. On the other hand, limitations on the number of repayment methods limit the flexibility of the borrower and lender in finding a repayment method which suits their special needs. By encouraging the use of fixed interest rate, fully amortizing, level payment mortgages, the Government has significantly limited the choices available to borrowers and lenders.

GOVERNMENT RESTRICTIONS ON CONTRACTS

The options available to mortgagors and mortgagees are typically restricted by numerous State and Federal laws and regulations which either require or proscribe certain provisions in contracts for mortgage loans. These State and Federal restrictions have been promulgated for various reasons and objectives; however, in the aggregate they reduce the supply and demand for mortgage credit by limiting the options available to both borrowers and lenders.

One of the more obvious restrictions on mortgage contracts is the maximum legal interest rate on the loan as contained in most state's usury laws. State laws also prescribe the conditions and procedures for foreclosures. In addition, the method of repayment is also typically defined or restricted by law or regulation. For example, the fully-amortized mortgage loans made by federally-chartered savings and loan associations cannot have any contractual periodic payment which exceeds the previous period's contractual payment. Therefore, although the Federal Home Loan Bank Board's regulations for federally-chartered savings and loan associations do not require equal monthly payments, they do prohibit any period of increasing contractual periodic payments on fully-amortized mortgage loans. The above restrictions on contracts constitute only a partial list, but they are among the most important restrictions on the options open to borrowers and lenders.

MORTGAGES PAYABLE IN FULL AT MATURITY

Prior to the 1930's, most mortgage loans -- like corporate and Treasury bonds -- were typically unamortized with all principal being paid at maturity. The term to

maturity was usually between 5 and 10 years and borrowers were required to make 50 percent downpayments. A large downpayment was required to reduce the loan-to-value ratio to a level consistent with the nature and risks of this type of mortgage loan.

This arrangement frequently found homeowners without the necessary funds when the loan matured. If the homeowner could not meet the lump-sum payment when the loan was due, the alternatives were either refinancing or default. Refinancing was usual and customary but not always available, especially in periods of tight credit.

A variation on the non-amortized loan was the use of sinking funds to accumulate the funds necessary to retire the debt at maturity. A borrower contracted to accumulate funds in a savings account by making periodic deposits so that the balance would equal the debt at maturity. This method closely resembles the fully-amortized mortgage loan with periodic payments; however, it fell into disuse in favor of the direct reduction loan. The direct reduction loan is a long-term, fixed interest rate, equal monthly payment, fully amortized loan. The current regulations of the Federal Home Loan Bank Board specifically instruct federally-chartered savings and loan associations to use the direct reduction method, where the periodic payments are applied directly to the reduction of the loan and not to a sinking fund in the form of a savings account. The use of sinking funds therefore represented the transitional stage between non-amortized and fully-amortized mortgage loans.

THE CURRENT FORM OF THE MORTGAGE LOAN

Most home purchases during the past 40 years have been financed by direct reduction loan. The monthly payments made in direct reduction of the principal of the loan and the loan's fully amortized nature permit a lower downpayment and longer term to maturity than that which prevailed under previous arrangements. The equal monthly payments also make it easy for households to plan their monthly budgets.

The direct reduction loan found its chief proponent in the Government during the 1930's through the activities of the Federal Housing Administration, the Home Owners' Loan Corporation, and the Federal Home Loan Bank Board's regulation of federally-chartered savings and loan associations. FHA insurance was and is now available only for this type of loan. The method has worked well during

the past four decades, and the Government's initial role had the effect of demonstrating the value of the instrument. If the method had not worked well, its use would not have spread outside the area of Government regulation.

However, the long term, fixed interest rate, equal monthly payment, fully amortized mortgage loan may not be the best instrument for all housing finance in today's inflationary economy. Most of the problems with this instrument relate to its requirements for a fixed interest rate set at the outset for the full term of the mortgage and equal monthly payments. The alternative mortgage forms to be presented below relax one or both of these requirements in an attempt to produce a more flexible mortgage debt instrument for certain purposes and conditions.

A difficulty with the fixed interest rate requirement is the problem which it creates for thrift institutions when market interest rates rise in response to unanticipated inflation or a general increase in the demand for credit. When market interest rates rise sharply, thrift institutions must raise their deposit rates to retain their depositors' funds. While they must pay higher rates on the entire amount of their borrowed funds, they receive higher rates only on their new loans. Consequently, they become tied to a low-yield portfolio while paying high rates for deposits. If market interest rates rise sharply, the savings and loan industry is threatened with a serious decline in net portfolio yield. If market rates fall sharply, the above sequence is reversed somewhat but limited by the borrower's right to refinance the loan after paying any prepayment penalties which may be required.

The requirement for equal payments may work hardships on certain classes of borrowers. First, the requirements for equal monthly payments is a burden on younger borrowers whose incomes are expected to rise over the life of the loan. This is because the earlier payments take a much larger portion of their disposable income than do later payments. With fixed payment mortgages, young households may have to postpone homeownership until their current income rises by an amount which adequately covers the fixed mortgage payments. As will be shown later in this section, there are alternative mortgage instruments whose repayments schedules better correspond to an individuals expected stream of future income.

A second problem with the fixed interest rate, equal payment requirement is that it creates problems for the borrower when inflation is expected. The lender demands that a premium be built into the interest rate to protect himself against inflation and this raises monthly payments immediately, whereas the borrower's money income is raised by inflation only gradually over the life of the mortgage.

In summary, the mortgage loan instrument in general usage today was a major innovation of the 1930's which has served both borrower and lender for the past 40 years. However, it is not the only way to finance housing, and in many instances it may not be the best way: no financial instrument is best for all transactions and conditions. Other instruments are available which offer more flexibility and might improve the efficiency of mortgage markets.

ALTERNATIVE MORTGAGE FORMS

Numerous alternative mortgage debt instruments are possible, and a few basic forms are briefly described below. Actually, there are as many possible instruments as there are ways to vary the manner of repayment of principal and interest, and some of these possibilities have already found their way into use. The main point to be made is that there are alternatives available to the mortgage loan instrument currently in general usage, each with its own advantages and disadvantages.

VARIABLE-RATE MORTGAGES⁵

Variable-rate mortgages replace the standard fixed mortgage rate with a flexible rate which is related to prevailing market interest rates. That is, the rate on the mortgage loan changes as market interest rates change. Actually, the variable-rate mortgage may be viewed as a sequence of refinanced short-term loans. In order to avoid the costs of constantly being involved in negotiations, the borrower and lender agree to accept an automatically determined rate tied by some formula to one or more interest rates. As a practical matter the borrower and lender also agree to disregard insignificant changes in market rates, and the rates on variable-rate mortgage loans change only with important changes in market rates of interest.

⁵For a study of this topic, see George von Furstenberg, The Economics of Mortgages with Variable Interest Rates, Federal Home Loan Mortgage Corporation, Monograph No. 2, Washington, 1973.

Variable-rate mortgages assume three forms. One form uses a fixed term to maturity and varies the monthly payments to reflect changes in the mortgage rate. A second form uses equal monthly payments and increases or decreases the term to maturity as interest rates rise or fall, respectively. The third form is a hybrid which varies the payments or the term to maturity, or both simultaneously, to reflect changes in interest rates.

A basic advantage of variable-payment mortgages is that they allow mortgage lenders to keep their deposit rates competitive with market rates and maintain the share of mortgages in the aggregate supply of credit at all times. As a result borrowers and homebuilders would have a better chance to obtain credit during periods of rising interest rates. In addition, by reducing the risks associated with fixed-rate contracting over long periods of time, a lower average expected cost of borrowing on larger volume may be attained. Both theory and empirical evidence indicate that variable-rate mortgages have a lower average interest rate than fixed-rate mortgages.

A disadvantage of the variable-payment form is that a substantial rise in interest rates could find some borrowers hard-pressed to meet their payments, and this could lead to some increase in default rates. The variable term form does not have this disadvantage.

Variable-rate mortgages are used widely in such developed countries as Britain, France, Germany, Italy, Sweden, Australia, and the Union of South Africa. In addition, experience has shown that both fixed-rate and variable-rate instruments coexist where both are available. In the United States the Federal Home Loan Bank Board regulations do not permit the use of the pure variable-payment form of the variable-rate mortgage by federally chartered savings and loan associations.

INTEREST-ONLY MORTGAGES

In one version of the interest only mortgage, the borrower pays only the interest on the outstanding principal during the early years of the loan. Another version entails early payments which do not even cover the full interest costs on the unpaid principal. In either case payments are lower in the initial years and increase when both interest and principal are paid during later years.

A thirty-year loan of \$20,000 at 7.75 percent requires equal monthly payments of \$143.29 under the currently predominant direct reduction method. A loan of the same size, maturity, and interest rate which entails the payment of the full interest only during the first five years and direct reduction with equal monthly payments thereafter requires equal monthly payments of \$129.17 for the first five years and \$151.07 for the remaining twenty-five years. Actually, it is not necessary to switch at some point to an equal monthly payment, direct reduction loan. Interest only could be paid on the first payment or payments and after some point the repayment of principal could be phased in slowly.

Interest only loans are riskier for lenders since no principal is initially repaid, and the risk is further increased when the initial payments do not even cover the full interest costs on the unpaid principal. The advantage to young borrowers is that the payment stream is lower in earlier years when their incomes are also likely to be lower. However, the lender might require a larger down-payment to cover the greater risk associated with the slow buildup in equity, and the advantages of the interest-only loan to the borrower might be thereby reduced.

MORTGAGE PAYMENTS RELATED TO THE BORROWER'S INCOME

This instrument is a fixed rate, variable monthly payment, fully amortized mortgage which has its monthly payments tied directly to the borrower's income over the period of the loan. This type of loan utilizes a fixed interest rate with variable monthly payments and requires the borrower to commit himself to make monthly payments which are an agreed upon percentage of his monthly income. The term to maturity is varied as the monthly payments vary.

In order to protect the lender, there is a need to set limits on the minimum amount of the monthly payments and on the degree of forbearance that he must show. As with the case with variable rate mortgages, the borrower and lender would typically agree to ignore all but large or long-term changes in the borrower's income, as this would reduce administrative costs.

The income-related mortgage is not available for use by federally-chartered savings and loan associations since Federal Home Loan Bank Board regulations currently require that no monthly payment exceed a previous payment.

APPENDIXPRIVATE AND GOVERNMENTAL PARTICIPANTS
IN HOUSING FINANCE

The intent of this section is to provide a detailed description of the various participants which were briefly mentioned above. The discussion is divided into three major segments: private sector primary lenders and originators of mortgages; Government-sponsored mortgage market support institutions, and public and private insurers and guarantors of mortgages. The discussion of each participant includes its purpose, regulation, authority, and limitations; its market share; and the segments of the market to which the participant caters.

PRIVATE SECTOR PRIMARY LENDERS AND
ORIGINATORS OF MORTGAGES

This section describes the activities of the private financial intermediaries which act as conduits for funds flowing from the saver to the purchaser of housing.

SAVINGS AND LOAN ASSOCIATIONS

The primary role of savings and loan associations is the pooling of savings funds for investment in residential mortgages. They are the largest source of conventional mortgage funds for both single-family and multifamily housing. They now hold over \$260 billion in assets and they originated about 55 percent of home mortgage loans made in 1972.

More than 75 percent of the savings and loan associations' assets are in residential mortgages. Other types of loans are made for commercial property, land development, construction and mobile homes. The greatest portion of mortgages held (87 percent at the end of May 1973) are conventional, with the remainder being FHA and VA mortgages. The high percentage of mortgages in the portfolios of savings and loan associations is due primarily to their history and experience as specialists in housing finance and the favorable tax treatment they receive for holding mortgages.

Organizationally, savings and loan associations fall into two categories: stock and mutual. Stock associations are privately owned and operate in a manner similar to a

corporation. In mutual associations, the equity is owned by the depositors who share in the associations gross income. Most associations, and all federally chartered associations are mutual institutions.

Savings and loan associations can be either State or federally-chartered. The federally-chartered associations are required to be members of both the Federal Home Loan Bank System and the Federal Savings and Loan Insurance Corporations. In addition to being regulated by these two agencies, federally-chartered associations must operate within the confines of State statutes and their charters.

The major Federal Home Loan Bank Board requirements include (a) economically sound mortgage loan policies; (b) a minimum proportion of assets (currently set at 5.5 percent of savings accounts and short-term borrowed funds) in either cash or United States Government securities; (c) limitations on mortgage loans such as the dollar amount per housing unit, maximum loan-to-value ratios and maturities, and specific lending areas; and (d) a ceiling on deposit rates, depending on size and term of deposit.

Although the interest rate that federally-chartered associations can offer on their deposits is limited by the deposit rate ceiling set by the Federal Home Loan Bank Board, their ability to compete for deposits is enhanced by their authority to offer higher interest rates than commercial banks on savings accounts. The current interest rate ceiling on savings and loan passbook accounts is 25 basis points above the passbook rate at commercial banks.

While all federally-chartered savings and loan associations must be insured, State chartered savings and loan associations may be insured or uninsured. The uninsured State associations are subject primarily to State statutes and are regulated by State banking agencies. State associations may choose to become members of the Federal Savings and Loan Insurance Corporation, in which case they are required to be members of the Federal Home Loan Bank Board. Thus, they are regulated by these two Federal agencies and by their State banking agency. Some states have set up insurance agencies similar to the Federal Savings and Loan Insurance Corporation as an alternative method of deposit insurance.

MUTUAL SAVINGS BANKS

Mutual savings banks (savings banks) are thrift institutions which intermediate between savers and borrowers. Total savings bank resources now exceed \$100 billion. Almost all of these funds are invested in long-term assets, about 67 percent of which are in mortgages.

Unlike savings and loan associations which can be either State or federally-chartered, savings banks are only State chartered. While they are primarily home mortgage lenders, they tend to have fewer restrictions on their investment policies than do savings and loan associations. As mutual organizations they are owned and operated for the benefit of their depositors, who receive a portion of the gross earnings as interest or dividends on deposits. The majority of savings banks are in the northeast, but some of the larger banks have member-owned companies in other parts of the country to assist them in mortgage acquisition and servicing.

The mutual savings bank mortgage orientation has been reinforced by the Tax Reform Act of 1969 which gave preferential tax treatment to earnings derived from mortgage investments.

Savings banks are the largest holders of FHA and VA home mortgages, holding 25 percent of all federally underwritten mortgages outstanding in 1971. However, the expansion of private mortgage insurance companies and the concomitant decline in the importance of FHA have led to an increase in privately insured conventional mortgage lending by savings banks in relation to FHA mortgages.

Savings banks often acquire mortgages as the result of commitments made to mortgage bankers. The mortgage bankers originate the loans and sell them to the savings banks, sometimes retaining the servicing function. In recent years, nearly one-third of all residential mortgage acquisitions by savings banks were obtained through mortgage bankers.

Most savings banks are insured by either the Federal Savings and Loan Insurance Corporation or by the Federal Deposit Insurance Corporation. Those belonging to the Federal Home Loan Bank System have access to Federal Home Loan Bank credit facilities, and are subject to the system's regulations and deposit rate ceilings.

COMMERCIAL BANKS

In recent years commercial banks have increased their activity in the field of mortgage finance. Due to the nature of their liabilities (mainly demand, rather than time deposits), they had, until the 1960's, primarily restricted themselves more to short-term investments as opposed to long-term investments such as mortgages. Growth and expansion of time deposits in the form of savings and certificates of deposit, and activities relating to trusteeship of pension funds, have allowed banks to participate increasingly in mortgage investments.

Mortgage investment by commercial banks equaled only about 31 percent of the dollar volume of their time and savings deposits, and about 90 percent of their gross mortgage acquisitions in 1972 were in conventional mortgage loans. Commercial banks generally keep their portion of real estate lending small because of alternative lending opportunities and a desire to maintain liquidity. Many commercial banks invest in long-term mortgages as a personal service to their customers though there are some commercial banks which in fact specialize in mortgages. On the average, commercial banks require lower loan-to-value ratios and shorter maturities on their mortgages than do other mortgage lenders.

In addition to long-term mortgage lending, commercial banks are quite active in the field of construction and development loans. The shorter maturity of these loans is more geared to the banks' liquidity requirements and fund availability, and the yields on construction loans are more attractive.

Commercial banks sometimes sell their mortgages (primarily single-family) to secondary market investors while retaining the servicing function. Some of the larger banks have also bought blocks of FHA and VA mortgages in the secondary market. Their involvement in making warehousing loans (loans to finance future mortgage activity) to mortgage companies and other lenders also directly supplements the availability of mortgage funds.

Bank regulation is either national or State, depending on the charter. National banks are allowed to invest the greater of 70 percent of their total time deposits or 100 percent of their capital or surplus funds in mortgage loans other than VA or FHA loans. Mortgage loans must constitute the first lien and be fully amortized by term.

Mortgage loan terms allow up to 90 percent loan-to-value ratio if the maturity date is not more than 30 years. State banks are supervised by State banking departments or agencies which generally allow more liberal mortgage lending terms.

LIFE INSURANCE COMPANIES

The general insurance function of life insurance companies creates a steady and sizeable inflow of funds with a steady but relatively small and predictable outflow, leaving large sums continually available for long-range investment. The investment pattern for these funds is based primarily upon return; as a result, mortgages must compete with other financial assets for life insurance companies' funds.

Life insurance companies' rate of mortgage lending has decreased over the last 20 years as they have shifted their funds toward corporate debt and equity holdings. In 1950, life insurance companies held about 19 percent of the stock of single-family mortgages, but this decreased to only about 6 percent in 1972. Multifamily holdings have remained about the same with life insurance companies accounting for about 28 percent of the market at the end of 1972. As a percentage of total mortgages held in life insurance companies' asset portfolios, 1-to-4 family mortgages accounted for 53 percent of such holdings in 1950 but this declined to 29 percent in 1972.

Life insurance companies may be stock or mutual in organization. The largest number are stock companies, but mutual companies have about two-thirds of the assets of all U.S. life insurance companies. All are State chartered and regulated by the legislation of their home States and that of States in which they operate. State regulations pertinent to the mortgage market include limitations on real estate and mortgage loan investments (for example, New York's limitation is 50 percent), as well as on stock and bond purchases. They have authority to purchase real estate as well as to invest in single- and multifamily mortgages, and have tended to become more active in modern real estate financing methods such as sale-leasebacks, joint ventures, etc.

State regulations also include maximum loan-to-value ratios (generally $66 \frac{2}{3}$ to 75 percent) and types of loans. FHA and VA loans are exempt from the loan-to-value regulation, however, and follow FHA and VA regulations.

The predictability of funds and low liquidity requirements enable life insurance companies to commit large sums for purchases of pools of single-family mortgages, multi-family and commercial mortgages, and income-producing property. Their single-family lending primarily takes the form of bulk purchases from mortgage banking companies. However, because of the lower yield on single-family mortgages, the trend is for reduction of single-family loans in favor of other investments.

MORTGAGE BANKING COMPANIES

The mortgage banking industry originated with the need of a mortgage brokerage operation to act as intermediary between lenders and home buyers and builders. The largest part of their business has traditionally involved the origination of FHA and VA mortgage loans for sale to institutional investors. However, due to the recent growth of private mortgage insurance companies, mortgage bankers are increasingly expanding their activities into the field of conventional mortgages. Corporate capital and warehousing loans (short-term loans, usually from commercial banks which finance mortgages held in preparations for sale to permanent investors) serve to finance the mortgage companies' loan origination and liquidity position. Today mortgage bankers service over \$100 billion in mortgages; they closed about 12 percent of mortgages closed in 1972. The mortgage bankers' rapid growth since World War II is related to the great reception of the FHA and VA programs. These federal programs, coupled with the mortgage bankers' secondary function of document inspection and servicing of the purchased loans, create a relatively easy and safe investment in mortgages for large investors via mortgage bankers.

A further function of the mortgage banking company is to channel mortgage capital from capital abundant areas to home buyers in capital-deficient areas.

Mortgage companies are corporations, and as such are subject to State corporate laws and regulations. A recent trend is for mortgage companies to become affiliated with large financial institutions, such as bank holding companies.

Federal and State supervision has been minimal. Lately, however, States have begun to adopt licensing laws for mortgage companies. Mortgage bankers dealing in FHA loans must be approved by FHA and are subject to periodic examination and audit by FHA as to adequate capitalization and

ability to service their loans. While there are no provisions in the law for VA to approve lenders, the import of VA regulations is to the effect that each lender must demonstrate ability to service loans and exercise proper credit judgment.

Mortgage bankers operate by soliciting commitments from large institutions for large blocks of single-family loans and multifamily loans. Income is drawn directly from borrower fees, from servicing fees, and sometimes from sales of loans; and indirectly from large escrow deposits (used as compensating balances for bank lines of credit and warehousing loans). Other income may be drawn from sideline activities, such as land development and construction loans, standby commitments, new cities development, and the like.

Loans originate from home or branch offices, real estate brokers and builders, and some through mortgage brokers and independent solicitors. On the sales side, the FNMA is one of the largest purchaser of mortgage company originated loans, while GNMA has had a great influence over mortgage banks' operations through use of the GNMA mortgage-backed security program. (For details, see FNMA, GNMA below.)

INVESTMENT TRUSTS

Real Estate Investment Trusts and Mortgage Investment Trusts act as financial intermediaries by issuing equity, debentures and commercial paper and borrowing with short-term loans to attract funds for investment in real estate. Real Estate Investment Trusts pay corporate income tax on only their retained earnings provided that 75 percent of their income is derived from real estate and 90 percent of their profits are distributed to the shareholders.

There are basically two types of trusts: equity trusts and mortgage trusts. Equity trusts buy existing office buildings and other income producing property. Most of the early trusts were of the equity type and tended to have only modest earnings record.

The mortgage trusts, however, have experienced excellent earnings in recent years and most of the newer trusts have been of this type.⁶ Rather than buying property directly,

⁶Peter A. Schulkin, "Recent Developments in the Real Estate Investment Trusts Industry," Federal Home Loan Bank Board Journal, VI, February, 1973, p. 11.

mortgage trusts invest primarily in construction and development loans and long-term mortgages.

The greatest impact that Real Estate Investment Trusts have had on housing finance has been in the provision of apartment house construction and development loans. Mortgage Investment Trusts now account for over 25 percent of apartment construction loans, which makes them the third largest construction and development lender after commercial banks and savings and loan associations. In other areas, such as the provision of one-to-four family construction loans, Mortgage Investment Trusts account for only 5 percent of the market and Real Estate Investment Trusts account for less than 1 percent of all long term loans made.

PENSION FUNDS

Due to their tremendous growth over the last 50 years, pension funds represent perhaps the largest untapped potential investor in mortgages in the United States. Private non-insured pension assets currently total over \$116 billion and State and local retirement fund assets amount to another \$74 billion. Most fund administrators have shunned mortgage investment for several reasons, among them low relative yields, a lack of knowledge or expertise in real estate investment, and a desire to avoid the investigatory and administrative problems of mortgage investment. However, pension funds have recently expressed some interest in multifamily and commercial mortgages which usually offer higher yields than single-family residential mortgages. Purchase-leasebacks seem to be the preferred real estate investment by pension funds; yield is usually 150 basis points above the first mortgage rate plus a share of the increase in gross receipts of the property.

Current mortgage investment from pension funds is small (e.g., 9 percent of total assets for State and local government pension funds combined and 2.5 percent for all non-insured pension-funds), but very recently the Government National Mortgage Association has had some success in attracting them to mortgage backed securities which do not require pension funds to develop facilities and staff for mortgage portfolio administration. However, until pension funds develop facilities and staff for mortgage portfolio administration, and until mortgages can compete viably with all other higher yielding investment alternatives, it is not likely that pension fund involvement in direct mortgage investment will be substantial. On the other hand, mortgage-backed bonds may eventually be more successful in attracting pension funds to mortgages indirectly.

SERVICE CORPORATIONS

A 1964 amendment to the Home Owners Loan Corporation Act permitted savings and loan associations to form a Real Estate Investment Trust-like organization called a service corporation. There are two types of service corporations that can be formed. A type "A" service corporation is a State-wide organization and all eligible associations in the State may invest in it. An association may invest 1 percent of its total assets in the capital stock, obligations or other securities of the corporation. The service corporation can then leverage the associations' investment with debt capital from other sources. A type "B-1" corporation (owned by five or more associations) may borrow an amount equal to 4 percent of the assets of the holders of the capital stock in secured debt and up to 2 percent of such assets in unsecured debt.

A type "B-2" corporation may be owned by only a limited number (less than five) associations and is permitted to borrow unsecured debt in an amount equal to the holders' investment in the corporation's stock, obligations or other securities and borrow security debt up to 4 times such investments by the associations.

The funds may be used for (1) the origination, purchasing, selling, brokeraging and warehousing of first mortgages; (2) the acquisition of unimproved real estate and its development and subdivision for sale or rental; (3) the acquisition of improved real estate to be held for rental; (4) the acquisition of improved real estate and its remodeling or renovation for sale or rental and, (5) joint ventures in any of the activities in (1) to (4).

Although the Home Owners' Loan Corporation Act permitted the formation of service corporations, most savings and loan associations expressed little interest in them due to the restrictive nature of Federal Home Loan Bank Board's interpretation of the Act. However, in 1970 the Federal Home Loan Bank Board relaxed its interpretation of the Act and the result has been considerably increased interest by savings and loan associations in such corporations. Whereas 86 service corporations were operating in October 1970, the number grew to more than 900 by the end of 1972.⁷

⁷Durand A. Holladay, "Working with REIT's in Commercial Lending," Federal Home Loan Bank Board Journal, VI, March, 1973, p. 26.

GOVERNMENT-SPONSORED MORTGAGE MARKET SUPPORT INSTITUTIONS

Since the 1930s, the Government has established or sponsored a number of institutions designed to facilitate the financing of residential housing, enhance the liquidity of the mortgage market and provide direct support to selected types of mortgages. This section describes the structure and operations of Government-sponsored mortgage market support institutions which provide "second layer" support to the private mortgage lenders discussed in the preceding section.

THE FEDERAL HOME LOAN BANK SYSTEM

The Federal Home Loan Bank System's main function is that of a central credit facility to supplement the resources of its member institutions, mainly savings and loan associations. It was created by the Federal Home Loan Bank Act in July 1932 and was modeled after the Federal Reserve System. The Nation was partitioned into 12 districts, each with its own Federal Home Loan Bank to provide services to its member institutions. The System is supervised by the Federal Home Loan Bank Board. The Board consists of three members appointed by the President with the advice and consent of the Senate. Chart 6 provides an overview of the Federal Home Loan Bank System.

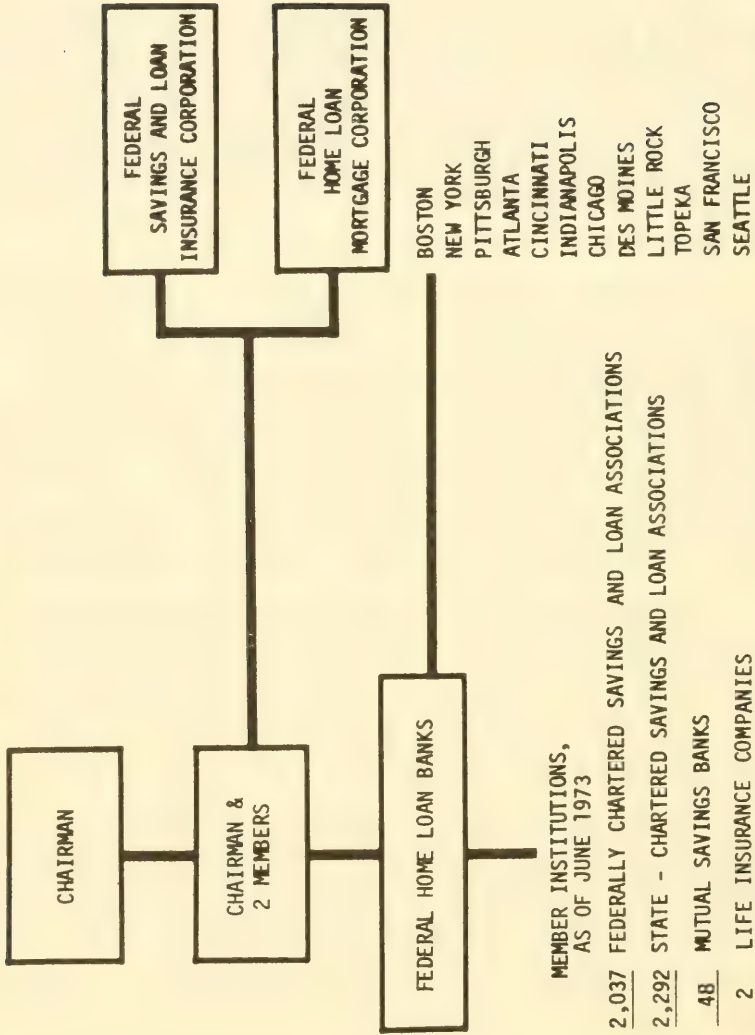
The Federal Home Loan Bank System extends credit in the form of advances to its mortgage lending member institutions. An advance is a loan of funds, usually secured by collateral in the form of mortgages. Federal Home Loan Bank Board regulations set the maximum amount which any member of the Federal Home Loan Bank System may borrow at 50 percent of its total savings balances, unless the Board specifically authorizes an exception.

The two major categories of advances are short- and long-term advances. Short-term advances have maturities ranging up to 12 months and are typically made to cover unusually large deposit withdrawals. Long-term advances may run as long as 10 years and are made for the purpose of loan expansion.

The rationale for the System's advances may be summarized as follows.

- . Advances serve as a source of funds to meet heavy or unusual net withdrawal demands on the deposits of member institutions.

THE FEDERAL HOME LOAN BANK SYSTEM



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM THE FEDERAL HOME LOAN BANK BOARD.

- . Advances supply funds to smooth the differences between the seasonal savings inflows to member institutions and the closing of construction and home-purchase loans.
- . Advances supplement local resources in capital deficit areas by helping to move funds to these areas from capital surplus areas.
- . Advances link mortgage-lending member institutions to the Nation's capital markets by the issuance of the system's consolidated obligation in large denominations for sale to individual investors and financial institutions.
- . Advances stabilize residential construction and financing in periods when monetary or financial conditions reduce the volume of mortgage lending.

The major sources of funds for the Federal Home Loan Bank System are derived from the sale of district Federal Home Loan Bank stock to member institutions, the retained earnings of the banks, the deposits of member institutions kept at the banks, and the funds obtained from the sale of debentures known as consolidated obligations. The consolidated obligations are sold in the Nation's capital markets and are the systems most important source of funds.

Up until the mid-1960's, the Board's policy was designed to promote housing construction through increases in expansionary advances. However, having found itself with inadequate resources to moderate the effects on mortgage lending institutions of the tight credit situation in 1966, the Board changed its policy on advances to bring into effect a countercyclical policy. When monetary conditions were easy and mortgage funds were plentiful, the district banks were directed to conserve their resources for periods of tight money when member institutions had difficulty attracting loanable funds. The Board changed its policy on advances again in the late 1960's when the emphasis was changed from a countercyclical policy to the goal of sustaining a high rate of residential construction. To implement this policy, the Board began to encourage expansionary advances. This policy resulted in an increase in the aggregate value of outstanding long-term advances from \$392 million in 1968 to \$5.0 billion by the end of 1972.⁸

⁸Federal Home Loan Bank Board, Selected Balance Sheet Data, July, 1973.

In addition to its role as a central credit facility, the Board also supervises the Federal Savings and Loan Insurance Corporation which insures savings deposits up to \$20,000 and regulates the lending activities of the member institutions. Members of the Federal Home Loan Bank System are subject to guidelines from the Federal Home Loan Bank Board such as liquidity ratios, types of mortgages, loan-to-value ratios and the maximum amount of a loan. In January, 1973, the Board changed its regulations to allow member institutions to issue subordinated debt in an amount of up to 50 percent of the member's net worth.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

The Federal National Mortgage Association (FNMA) was chartered and organized in 1938 by the Federal Housing Administration to provide secondary market support for the new FHA mortgages. During its first decade of operation the FNMA bought FHA mortgages when mortgage funds were scarce and sold mortgages when wartime conditions led to an abundance of loanable funds while investment outlets were restricted. In 1948, the FNMA was authorized to purchase VA mortgages. Although the Emergency Home Finance Act of 1970 gave the FNMA the authority to purchase conventional mortgages, actual purchases did not begin until February, 1972, and virtually all of its activity has been in the area of Government-insured or -guaranteed mortgages. Conventional mortgages accounted for only 1 percent of its mortgage portfolio at the end of 1972.⁹ However, the FNMA has recently increased its purchases of conventional mortgages.

Over the years, the FNMA has used its resources to support a variety of Government housing programs. This was changed by the Housing and Urban Development Act of 1968 which divided the "old" FNMA into two corporate entities: The "new" FNMA, privately owned and retaining the secondary market function and, the Government National Mortgage Association, within the Department of Housing and Urban Development, and taking over the special assistance and management and liquidation functions.

Although the FNMA is now privately owned, the President of the United States appoints five of its fifteen directors. The Secretary of HUD has general regulatory

⁹Department of Housing and Urban Development, Survey of Mortgage Lending Activity.

responsibility over the corporation. Within statutory guidelines, the Secretary of HUD (1) sets FNMA's debt ceiling and the ratio of debt to capital, (2) sets the maximum rate for cash dividends, and (3) approves the issuance of all stock, obligations, and other securities. The Secretary of the Treasury must approve all debt issues, including the terms and conditions of sale, in order to assure coordination with Treasury debt operations.

The FNMA's basic function is to maintain a secondary market facility for residential mortgages. It fulfills this function by buying and selling mortgages. The price at which FNMA issues commitments to purchase mortgages is determined by the Free Market System auction procedure. Under the auction, commitments for the purchase of mortgages are offered on a competitive basis.

The sellers of mortgages to the FNMA include mortgage companies, commercial banks, savings and loan associations, mutual savings banks and others. During 1972 mortgage companies accounted for 76 percent of the mortgages purchased by the FNMA, banks and trusts accounted for 14 percent and the remainder was purchased from savings and loan associations, life insurance companies, the GNMA and other lenders. Sellers must meet and maintain FNMA standards, most of them also have FHA approval. Normally, FNMA sellers will retain the servicing of the loans.

Funds for mortgage purchases and operations are obtained from mortgage repayments, sale of debentures, notes and other obligations, commitment fees, proceeds from mortgage sales and the differential between interest income and borrowing costs. All sellers of mortgages to the FNMA are required by law to hold common stock of an amount equal to $1/4$ of 1 percent of the unpaid principal amount of mortgages and loans purchased or to be purchased by the FNMA from such sellers. All servicers of one-to-four-family home mortgages for the FNMA are required to hold common stock in varying percentages of the unpaid principal amount of mortgages serviced by the FNMA.

THE FARMERS HOME ADMINISTRATION

The purpose of the Farmers Home Administration is to administer the farm credit and rural housing programs authorized by three principal statutes, as amended: Title V of the Housing Act of 1949; the Consolidated Farm and Rural Development Act of 1972; and part A, Title III of the Economic Opportunity Act of 1964. The financial

assistance authorized by these pieces of legislation is rendered to farmers and residents of rural areas in the form of direct loans, insured loans, and grants. The funds for loans and grants made by the Farmers Home Administration are obtained from three sources: annual appropriations by Congress, loans from the United States Treasury, and private lenders who supply funds for loans which are insured by the agency. Most loans are now made on an insured basis and utilize funds borrowed from private lenders rather than the United States Treasury.

The Farmers Home Administration entered the area of housing finance under the authority of the Housing Act of 1949 by making direct loans to owners of farms. In 1961, the direct housing loans were extended to residents in rural areas in general. Virtually all of the housing finance furnished by the Farmers Home Administration was in the form of direct loans financed by borrowing from the U.S. Treasury until the creation of the Rural Housing Insurance Fund in 1965 allowed this agency to significantly expand its operations by switching from direct to insured loans.

The direct loan programs were restricted in their scope by the need to borrow funds from the Treasury, because the use of Treasury funds required the inclusion of the amount of the direct loans in the national debt and the budget. The insured loan program allowed the Farmers Home Administration to finance rural housing loans through a revolving fund. First a loan is made with funds obtained from the revolving fund and then this loan is sold to a private investor under an insurance agreement. Today the majority of loans are sold in "blocks" in the capital market. This method of insuring and selling loans provides a method by which the bulk of outstanding insured loans does not have to be included in the budget or entered into the national debt.

The basic loan program of the Farmers Home Administration provides for the insurance of housing loans to residents of rural areas with or without interest rate "credits." In August 1973 the maximum interest rate on such loans was 7 3/4 percent, and the rate could be reduced to as low as 1 percent, based upon the borrower's ability to pay, as determined by the Secretary of Agriculture. These loans are provided to enable rural residents to obtain decent, safe, sanitary and modest housing at reasonable rates. The income level of the applicant determines the maximum amount of the loan, and the program

is limited to low- and moderate-income families. The losses incurred by the interest rate subsidies are financed from general tax revenues.

At the end of 1972, the Farmers Home Administration was servicing \$5.3 billion in residential mortgage debt outstanding. About \$4.9 billion of this outstanding debt was financed by sales of Farmers Home Administration's insured notes which bear the full faith and credit of the United States.

The Farmers Home Administration is headed by the Administrator who is appointed by the President. This agency maintains 42 State offices which serve the 50 States, Puerto Rico and the Virgin Islands, and 1,723 county offices. The county offices are each under the direction of a county supervisor and are located to serve all agricultural counties. Local citizens participate in Farmers Home Administration programs in the farm county committees. These are appointed three-person committees which assist in the administration of the programs.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

The Government National Mortgage Association (GNMA) was created in 1968 to assume responsibility for the special assistance and management and liquidation functions of the "old" FNMA. The GNMA is a wholly-owned corporate instrumentality of the U.S. Government, operating within HUD, with the Secretary of HUD determining general GNMA policies and appointing GNMA officers.

The special assistance functions are operated exclusively for the account of the Federal Government with funds provided by the Secretary of the Treasury under authorization of Congress for the purchase of mortgages for designated Government housing programs. Programs under special authorization include housing in Guam and Alaska; housing in disaster and urban renewal areas; housing under the Sections 235 and 236 single and multi-family programs; and housing for the elderly, armed forces, and other low- and moderate-income families. Many of the mortgages obtained under these programs have been later sold to private lenders, particularly under the procedure known as the "Tandem Plan" described below.

The management and liquidation functions provide for the GNMA to manage and liquidate the portfolio of mortgages acquired for the account of the Government between February

1938 and November 1954. This includes the pre-Charter mortgage portfolio and commitments outstanding of the "old" FNMA. Also included in the management and liquidation functions were mortgages that other departments and agencies of the Government had directly acquired -- for example, mortgages held by the Reconstruction Finance Corporation, the Defense Home Loan Corporation, and in later years, mortgages received from the Public Housing Administration. This function represented the centralization of Government mortgage liquidation programs. The GNMA acts as fiduciary with respect to participations in these mortgages which were sold to private investors prior to August 1968 and of which \$4.4 billion are currently outstanding. During fiscal year 1973 over \$1 billion of mortgages in the GNMA portfolio were sold directly to lenders during periodic auctions.

The GNMA's authorization to purchase mortgages is limited (the present limit is \$7.75 billion), but its authorization can be replenished by resale of the mortgages it buys. For example, in certain of GNMA's Tandem Plans, the GNMA purchases the mortgages insured under subsidized housing programs from private lenders and then resells them to the FNMA or other investors at the lower prevailing market price. In an effort to encourage private lenders to hold these mortgages, the GNMA held the first auction of interest subsidy mortgages in the amount of \$229 million in June 1972.¹⁰ In fiscal year 1973, the GNMA sold in auctions a total of \$1.1 billion of mortgages purchased under the Tandem Plan. The funds to cover the losses on the Tandem Plan, which totaled \$65 million in fiscal year 1973, are charged against operations of GNMA's revolving funds.

In addition to its special assistance and management and liquidation functions, the GNMA has developed a number of instruments that are sold by private lenders to attract more funds into housing. These instruments are the pass-through mortgage-backed security and the mortgage-backed bond, both of which are fully guaranteed by GNMA as to the timely payment of principal and interest.

The pass-through securities are issued in demoninations of \$25,000 and are fully amortized with the investor receiving monthly payments of principal and interest as

¹⁰Department of Housing and Urban Development, Government National Mortgage Association, Annual Report 1972, Washington, D.C.: Government Printing Office, 1972.

well as any prepayments of the mortgages backing the pass-throughs. Almost all of the pass-throughs have been issued by mortgage companies as an alternative to selling the mortgages they originate directly to institutional investors. The issuer of the pass-throughs must pay the GNMA an application fee of \$500 per pool of mortgages to obtain a commitment from the GNMA to guarantee the pass-through plus a fee of 6 basis points (.006 percent) on the unpaid principal balance on the pass-through securities.

As of June 30, 1973, a total of \$7.8 billion of pass-throughs had been sold. During the first 3 years of the program, savings and loan associations and mutual savings banks purchased over 60 percent of these securities. However, since March 1973 over 80 percent of the pass-throughs issued have been sold to pension funds, life insurance companies and other institutions.

FEDERAL HOME LOAN MORTGAGE CORPORATION

The Emergency Home Finance Act of 1970 created the Federal Home Loan Mortgage Corporation the principal purpose of which is to serve as a central credit facility and secondary market for conventional mortgages. The Federal Home Loan Mortgage Corporation is a private corporation and is a member of the Federal Home Loan Bank System. The three Presidentially-appointed directors of the Federal Home Loan Bank Board also serve as the directors of the Corporation. The Federal Home Loan Mortgage Corporation was initially financed by the sale of \$100 million in non-voting stock with a no-call provision to the twelve Federal Home Loan District Banks. Additional funds have been acquired through the sale of bonds and participation certificates.

Since the majority of mortgages originated by lenders are of the conventional type, the absence of a central credit facility for these mortgages limited the ability of public agencies to moderate fluctuations in housing starts and to insure that mortgage lenders have adequate funds and liquidity.

The Federal Home Loan Mortgage Corporation plays two primary roles as a mortgage market support agency. First, it acts as a financial intermediary and mortgage broker by purchasing mortgages for its own portfolio or for sale to other investors. Second, it is working to develop a private secondary market for mortgages that will exist independently of Government-sponsored mortgage market support institution.

Although the Federal Home Loan Mortgage Corporation was established to support the conventional market, most of its initial purchases have been Government-insured or -guaranteed mortgages. Conventional mortgages accounted for about 12 percent of its total purchases during 1972. However, the Federal Home Loan Mortgage Corporation anticipates that in 1973 more than 80 percent of its volume will be in the conventional mortgage sector. As a new organization, the scope of its activities is small relative to the size of the market. The Federal Home Loan Mortgage Corporation's purchases of FHA/VA mortgages in 1972 accounted for only 4.9 percent of the FHA/VA mortgages originated that year.

The sales participation certificates represent a participation in groups of conventional mortgages acquired by the Federal Home Loan Mortgage Corporation. The Federal Home Loan Mortgage Corporation acquires a participation interest by providing a portion of the funds for a group of mortgages originated by a private lender. The Federal Home Loan Mortgage Corporation then separates this acquired participation into certificates in amounts designed for easy marketability and sells them to investors at a yield slightly below the yield on the pool of mortgages. The Federal Home Loan Mortgage Corporation guarantees the timely payment of interest and principal. Approximately \$550 million of these certificates had been sold by the end of 1972, mostly to savings and loan associations.¹¹

INSURERS AND GUARANTORS

This subsection deals with the principal public and private institutions that insure or guarantee mortgages:

- . Federal Housing Administration;
- . Veterans Administration;
- . Private mortgage insurance companies.

By insuring or guaranteeing the prompt payment of principal and interest on individual mortgages, as well as the payment of claims on default, these institutions contribute to the marketability of mortgages by decreasing the risk of mortgage investment. This enables large quantities of mortgages to be lumped in saleable blocks and exchanged on the secondary market with relative safety for the investor.

¹¹Federal Home Loan Mortgage Corporation, 1972 Annual Report, Washington, D.C., 1973.

Each institution is discussed below as to operation and market acceptability, volume, specific segments of the market which are served, and the effect on lending risk.

FEDERAL HOUSING ADMINISTRATION

The Federal Housing Administration was created by the National Housing Act in 1934 with the authority to insure mortgage loans made by private lenders on homes through creation of a mutual mortgage insurance fund. Prior to 1934, residential mortgages often required a 50 percent downpayment and a 5 year term during which interest was payable annually, frequently with the principal falling due in full at the end of the term. FHA changed the nature of housing finance by offering different terms: long-term, level debt service and low downpayment. This resulted in reduced monthly payments and enabled greater numbers of families with little savings but adequate incomes to qualify for home loans. The principal purposes of FHA are to improve home financing practices, to encourage improvements in housing standards and conditions, and to facilitate homeownership.

FHA is a Government agency, operating within the Department of Housing and Urban Development. The FHA Commissioner is an Assistant Secretary of HUD.

FHA administers a number of mortgage insurance programs under which mortgage lenders are insured against loss in financing first mortgages on single-family homes, on multifamily housing projects and on loans to finance repairs and/or home improvements. FHA is designed to be a self-funded entity; the main source of funds being a mortgage insurance premium paid by the mortgagor. This generally amounts to 1/2 percent of the principal balance outstanding.

The security of FHA-insured loans makes them the safest investment available in the mortgage market. The 100 percent Government backing makes them essentially risk free, and consequently they are the most heavily-traded instruments in the secondary mortgage market, accounting for about 39 percent of all residential loan purchases in 1972.

The current ceiling on allowable interest rates for FHA-insured mortgages is 8.5 percent. The borrower must also pay the 1/2 percent insurance premium, making the effective borrowing costs of an FHA loan 9 percent. When

market interest rates on mortgage debt rise above the FHA ceiling rate, lenders and investors must acquire FHA loans at a discount in order to obtain a competitive yield. Although the mortgagors are not permitted to pay the discount directly, they do so indirectly by paying a higher price for the house because the seller must pay the discount.

Processing bottlenecks, insurance payment delays and competition from private mortgage insurance companies have contributed to declines in the last two years in the volume of FHA insurance written.

FHA also administers a number of programs that do not involve mortgage insurance. The non-mortgage insurance programs include:

- . a rent supplement program under which low-income families in approved projects can receive rent supplement payments for that portion of the rent which is in excess of 25 percent of their family income,
- . homeownership programs which assist low-income families in acquiring a place of residence by making assistance payments on mortgages to lenders on behalf of qualified borrowers, and
- . a nonprofit sponsor assistance program which will loan interest-free money to qualifying nonprofit organizations for preconstruction expenses.

VETERANS ADMINISTRATION

The function of the Veterans Administration in housing is to aid veterans in obtaining loans on favorable terms to buy or build homes with no downpayment required by the Government. It maintains three major areas of authority:

- . to partially guarantee loans made to veterans by eligible lenders,
- . to insure loans made to veterans by private lenders, and
- . to make direct loans to veterans in instances where mortgage credit is not otherwise available.

Eligible veterans include World War II and Korean Conflict veterans, unremarried widows of veterans and veterans of service after January 31, 1955. In fiscal year 1973, VA guaranteed more than 365,000 home loans totalling nearly \$8.5 billion.

Lenders are not required to be approved by VA in order to process loans. However, VA regulations provide that lenders must demonstrate ability to properly service loans, maintain adequate loan accounting records, and make proper credit determinations. The distinction between the supervised and non-supervised lenders lies in the fact that supervised lenders may close loans and report them for automatic guarantee, whereas non-supervised lenders are required to submit all loans to VA for approval before closing.

Practically all VA-guaranteed loans relate to the purchase of single-family homes, mobile homes and units in condominium projects. VA is authorized to insure loans, but this form of lender protection is intended to be used principally for short-term business loans, although a few home loans have been insured.

The VA guaranty amounts to 60 percent of the loan, but not to exceed \$12,500. VA appraises each property which is to be the security for a guaranteed loan. Before a loan may be guaranteed, there must be a determination made that the veteran is a satisfactory credit risk and that he has the income with which to repay the loan obligation. All VA loans are required to be secured by first liens.

The attraction of VA loans to lenders and investors lies in the fact that the protection afforded by the guaranty reduces the risk of mortgage investment. In the event of default, VA will settle with the mortgage holder on the basis of allowing interest accrued to the date of foreclosure, plus foreclosure expenses. All such settlements are paid in cash and such payments are made promptly following VA's receipt of guarantee claims.

VA home loans have several advantages for veterans.

- . No downpayment is required.
- . The loan may be repaid in part or in full at any time without penalty.

- In the event of temporary distress, bringing about difficulties in the making of loan payments, VA will arrange for forbearance and indulgence.
- The veteran has the benefit of VA appraisal services, construction supervision, a builder's warranty, and oversight of the mortgage lender's activities.

The current ceiling interest rate on VA mortgages is 8.5 percent. Although veterans are forbidden to pay discount points directly, they do so indirectly by paying a higher price for the house.

PRIVATE MORTGAGE INSURANCE

In the past few years private mortgage insurance companies have become increasingly active in the field of mortgage insurance. Private mortgage insurance companies' role in the market is somewhat supplementary to FHA/VA and offers the lender of conventional loans an inducement to invest in high loan-to-value ratio mortgages with relatively little risk. The availability of high loan-to-value conventional mortgages makes homeownership a possibility for a larger number of families.

Private mortgage insurance companies are subject to the regulation of the States in which they operate. Most of the States have granted licenses to mortgage insurers under general provisions of the insurance codes, although some are more comprehensive -- specifying liquidity requirements, domain, maximum coverage, total liability, dividend policy, reserve requirements, fee limitations, etc.

A lender who has been approved by a private mortgage insurance company will submit an application for insurance on a loan when he feels that the credit of the applicant borrower is satisfactory and wishes to avoid the risk of property value decline. This usually is on loans with a loan-to-value ratio of 90 percent or higher. The highest loan-to-value ratio on conventional mortgages that the Federal Home Loan Bank Board permits member savings and loan associations to originate is 95 percent. The Comptroller of the Currency restricts national banks to a maximum loan-to-value ratio of 90 percent on such loans. Since private mortgage insurance typically covers the top 25 percent of a 95 percent loan (pays 25 percent of a total claim after foreclosure) that means that the property value would have to decline about 30 percent (5 percent equity and 25 percent coverage) before the lender would actually lose money on his investment in the mortgage.

The mortgagor usually pays the insurance premium, typically 1/4 percent per annum on the unpaid balance of the loan. This is about one-half the FHA premium. The policy is subject to cancellation at the discretion of the lender. After the mortgagor has amortized the loan to 60 to 70 percent of value, the lender will frequently permit the policy to terminate because risk of losing principal through foreclosure is then negligible.

Private mortgage insurance companies process insurance applications very quickly, usually reporting a decision within 24 to 48 hours of receipt of the application. Insurance claims are also processed rapidly. In addition to their relatively low costs, this gives private mortgage insurance companies a significant advantage over FHA.

The Federal National Mortgage Association and Federal Home Loan Mortgage Corporation have approved at least eight private mortgage insurance companies whose insured loans they will purchase in their conventional secondary market operations.

CHAPTER 4

SUSPENDED SUBSIDY PROGRAMS

INTRODUCTION

The Congress of the United States in 1949 established as a national goal "a decent home and a suitable living environment for every American family." Almost two decades later, despite substantial progress in the elimination of substandard housing, full achievement of that goal continued to elude us. Consequently, the Congress in the Housing Act of 1968 added to the original objective a specific 10 year production target aimed at making the goal a reality. Congress thereby determined that the goal of a decent home for all "could be substantially achieved within the next decade by the construction or rehabilitation of 26 million housing units, 6 million of them for low- and moderate-income families."

To initiate new progress toward that production target, several new programs were initiated and existing programs expanded in Fiscal Year 1969. A summary of the characteristics of the major subsidized housing programs is contained in Table 1. These programs have two elements in common: they are basically production programs (i.e., designed to increase the supply of housing); and the subsidy payments are tied to the dwelling unit. If the occupant family moves out of the unit, it loses the housing subsidy.

Under these programs, rental and homeownership units were produced so that the varied life styles and needs of low- and moderate-income families could be accommodated. Rural areas were accorded a share of the new dwellings; profit-making as well as non-profit developers and sponsors had a role. The Tax Reform Act of 1969 further encouraged involvement of profit-making enterprises by providing special treatment for investors in low- and moderate-income housing.

The legislative history of the 1968 Housing Act is replete with references to the desire to replace substandard with standard housing, to stabilize the housing industry, to retard the decay of central cities and to provide training and jobs for disadvantaged persons. But there apparently was little consideration of the economic and social costs and benefits, the equity aspects and the overall impact on local housing markets of subsidizing large numbers of newly built units for lower income families.

TABLE 1
SUMMARY OF MAJOR SUBSIDY PROGRAM CHARACTERISTICS

PROGRAM	OBJECTIVE	MORTGAGE LIMITS	SUBSIDY	ELIGIBILITY CRITERIA	INCOME LIMITS FOR ADMISSION
LOW RENT PUBLIC HOUSING	ASSIST LOCAL HOUSING AUTHORITIES (LHA) TO PROVIDE DECENT, SAFE, AND SANITARY HOUSING FOR LOW-INCOME FAMILIES AT RENTS THEY CAN AFFORD.	COST FOR DWELLING CONSTRUCTION AND EQUIPMENT MAY NOT EXCEED BY MORE THAN 10% THE PUBLISHED PROTOTYPE COST FOR THE AREA.	LOANS MADE FOR PLANNING AND CONSTRUCTION. ANNUAL CONTRIBUTIONS MADE TO COVER DEBT SERVICE OR, FOR LEASED UNITS, THE DIFFERENCE BETWEEN ACTUAL AND MARKET RENTS. CONTRIBUTIONS ALSO AVAILABLE FOR OPERATING SUBSIDIES. TENANT TO PAY NO MORE THAN 25% OF ADJUSTED INCOME TOWARD RENT.	APPLICANT MUST BE A "FAMILY" AS DEFINED BY LHA, OR IF A SINGLE PERSON, MUST BE AT LEAST 62 YEARS OF AGE, DISABLED, HANDICAPPED, OR BE DISPLACED BY URBAN RENEWAL, OTHER GOVERNMENTAL ACTION, OR NATURAL DISASTER.	LIMITS SET BY LHA AND APPROVED BY HUD. LIMITS USUALLY SET AT "TYPICALLY LOW ANNUAL WAGE" IN THE AREA.
RENT SUPPLEMENT	TO MAKE GOOD QUALITY HOUSING AVAILABLE TO LOW-INCOME FAMILIES AT A COST THEY CAN AFFORD.	LIMITS APPLICABLE TO SECTION 236 OR OTHER PROGRAM UNDER WHICH THE PROJECT IS FINANCED.	DIRECT CASH PAYMENTS TO OWNER OF HOUSING ON BEHALF OF TENANT TO COVER DIFFERENCE BETWEEN TENANT'S PAYMENT AND ECONOMIC RENT. TENANT TO PAY 25% OF ADJUSTED INCOME OR 30% OF ECONOMIC RENT WHICHEVER IS GREATER.	THE FAMILY OR INDIVIDUAL MUST BE AN OCCUPANT OF SUB-STANDARD HOUSING. VICTIM OF NATURAL DISASTER, DISPLACED BY GOVERNMENT ACTION, HANDICAPPED, OR AT LEAST 62 YEARS OF AGE; A FAMILY MAY ALSO QUALIFY IF HEAD OR SPOUSE IS IN ARMED FORCES.	ESTABLISHED BY HUD, NO HIGHER THAN THE LOCAL PUBLIC HOUSING LIMITS.
SECTION 235	TO MAKE HOME-OWNERSHIP OF GOOD QUALITY HOUSING MORE READILY AVAILABLE TO LOWER INCOME FAMILIES.	\$18,000 (OR \$21,000 IN HIGH COST AREAS); \$3,000 CAN BE ADDED FOR PROPERTY CONSISTING OF FOUR BEDROOMS PURCHASED BY FAMILY OF FIVE OR MORE PERSONS.	DIRECT CASH PAYMENTS TO LENDER ON BEHALF OF LOWER INCOME FAMILY, WHICH CAN REDUCE AMORTIZATION COST TO AS LOW AS 1% INTEREST. HOMEOWNER MUST PAY A MINIMUM OF 20% OF ADJUSTED INCOME TOWARD REGULAR MONTHLY PAYMENTS.	MUST BE "FAMILY" OF TWO OR MORE PERSONS RELATED BY BLOOD, MARRIAGE, OR OPERATION OF LAW, OR HANDICAPPED PERSON, OR A SINGLE PERSON AT LEAST 62 YEARS OF AGE.	ADJUSTED FAMILY INCOME MUST NOT EXCEED 135% OF PUBLIC HOUSING INCOME LIMITS FOR THE AREA. "EXCEPTION" LIMITS MAY BE USED FOR UP TO 20% OF CONTRACT AUTHORITY.
SECTION 236	TO PROVIDE GOOD QUALITY RENTAL AND COOPERATIVE HOUSING FOR PERSONS OF LOWER INCOME.	VARIES BY SIZE OF UNIT, TYPE OF STRUCTURE, AND COST LEVEL OF AREA FROM \$9,200 TO \$37,935 PER UNIT; TOTAL LIMIT OF \$12.5 MILLION PER PROJECT.	DIRECT CASH PAYMENTS TO LENDER ON BEHALF OF OWNER. PAYMENTS CAN REDUCE AMORTIZATION COST TO 1% INTEREST. TENANT PAYS THE GREATER OF 25% OF ADJUSTED INCOME OR ESTABLISHED "BASIC" RENT.	SAME AS SECTION 235. (ALSO 10% OF DWELLING UNITS MAY BE USED FOR SINGLE PEOPLE UNDER 62 YEARS OF AGE.)	SAME AS SECTION 235.
FARMERS HOME ADMINISTRATION SECTION 502 INTEREST CREDIT	TO MAKE HOMEOWNERSHIP OF GOOD QUALITY HOUSING MORE READILY AVAILABLE TO LOW- AND MODERATE-INCOME RURAL FAMILIES.	100% OF APPRAISED VALUE FOR MODEST HOUSING	CREDITS WHICH REDUCE AMORTIZATION COST TO AS LOW AS 1% INTEREST. HOMEOWNER MUST PAY A MINIMUM OF 20% OF ADJUSTED INCOME TOWARD MORTGAGE PAYMENTS, TAXES, AND INSURANCE.	MUST BE A FAMILY WHICH DOES NOT HAVE AN ADEQUATE HOME AND WILL BECOME RESIDENT IN A RURAL AREA AFTER THE LOAN IS CLOSED. ALSO UNABLE TO OBTAIN CREDIT AT REASONABLE TERMS.	\$7,000 ANNUAL ADJUSTED INCOME.
FARMERS HOME ADMINISTRATION SECTION 504	ASSIST RURAL OWNER-OCCUPANTS TO MAKE THEIR DWELLINGS SAFE AND SANITARY AND TO REMOVE HEALTH HAZARDS.	MAXIMUM LOAN \$2,500; ADDITIONAL \$1,000 MAY BE USED FOR REPAIRS OR IMPROVEMENTS INVOLVING WATER SUPPLY OR PLUMBING.	INTEREST RATE IS 1%; LOAN REPAYABLE IN UP TO TEN YEARS.	MUST BE HOMEOWNER OR LONG TERM LESSEE LIVING IN HAZARDOUS DWELLING IN A RURAL AREA, AND UNABLE TO OBTAIN CREDIT AT REASONABLE TERMS.	LOW-INCOME; INCOME SUFFICIENT TO ALLOW REPAYMENT, BUT NOT SUFFICIENT TO QUALIFY FOR SECTION 502.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF AGRICULTURE.

In 1970, in a major production effort, about 470,000 subsidized units were started or substantially rehabilitated under HUD and Farmers Home Administration (FmHA) programs, more than twice as many as in any previous year. The new subsidized starts alone made up almost 30 percent of all housing starts in 1970 (Table 2). In the same year, almost 80,000 existing housing units were committed for subsidy to house low- and moderate-income families. In many cases, these housing units were improved in quality through rehabilitation (Table 3). In 1971, about as many subsidized units were started or rehabilitated as in 1970.

Even as early as 1970, however, concern about subsidized housing programs began to surface. The House Committee on Banking and Currency concluded after an investigation that "FHA may be well on its way toward insuring itself into a national housing scandal."¹ Moreover, purchasers were reported to be abandoning homes in some parts of the country and overproduction was apparent in other parts. Widely publicized scandals in 1971 raised additional questions about Government subsidized housing programs. A 1972 internal HUD audit² indicated that the cost of Section 236 dwelling units was higher than similar conventionally built units and that architectural fees were often excessive; a General Accounting Office audit³ of the Section 236 program in 1972 reported excessive land valuations, among other problems. Several press articles referred to HUD as the Nation's largest slumlord as acquisitions by the Secretary began to mount. Members of Congress and HUD received numerous letters from persons expressing dismay that families with income similar to theirs were receiving brand new housing while paying less rent because of Government subsidy payments.

¹U.S. Congress, House Committee on Banking and Currency, Staff Report Recommendations, Investigation and Hearing of Abuses in Federal Low- and Moderate-Income Housing Programs, Washington, D.C.: Government Printing Office, 1970, p. 1.

²Department of Housing and Urban Development, Office of Audit, Report on Audit of Section 236 Multifamily Housing Program, Washington, D.C., January 29, 1972.

³General Accounting Office, Opportunities to Improve Effectiveness and Reduce Costs of Rental Assistance Housing Program, Washington, D.C., January 10, 1973.

TABLE 2

ANNUAL HOUSING PRODUCTION, 1961-1972

(UNITS IN THOUSANDS)

CALENDAR YEAR	HOUSING STARTS				FEDERALLY SUBSIDIZED REHABILITATION	MOBILE HOME SHIPMENTS	TOTAL HOUSING PRODUCTION
	TOTAL	NON- SUBSIDIZED	FEDERALLY SUBSIDIZED	SUBSIDIZED AS PERCENT OF TOTAL			
1961	1,365.0	1,328.8	36.2	2.7%	2.4	90.2	1,457.6
1962	1,492.5	1,453.6	38.9	2.6	2.5	118.0	1,613.0
1963	1,634.9	1,587.3	47.6	2.9	2.6	150.8	1,788.3
1964	1,561.0	1,505.9	55.1	3.5	3.4	191.3	1,755.7
1965	1,509.7	1,446.0	63.7	4.2	5.9	216.5	1,732.1
1966	1,195.8	1,124.9	70.9	5.9	11.6	217.3	1,424.7
1967	1,321.9	1,230.5	91.4	6.9	16.1	240.4	1,578.4
1968	1,545.4	1,379.9	165.5	10.7	36.1	318.0	1,899.5
1969	1,499.5	1,299.6	199.9	13.3	32.1	412.7	1,944.3
1970	1,469.0	1,039.2	429.8	29.3	40.7	401.2	1,910.9
1971	2,084.5	1,654.5	430.0	20.6	41.0	496.6	2,622.0
1972	2,378.5	2,039.7	338.8	14.2	50.8	575.9	3,005.2

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING .

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; DEPARTMENT OF AGRICULTURE; MOBILE HOME MANUFACTURERS' ASSOCIATION .

TABLE 3

UNITS COMMITTED FOR SUBSIDY,⁽¹⁾ 1961 - 1972

(UNITS IN THOUSANDS)

YEAR	NEW	EXISTING OR REHABILITATED	TOTAL
1961	33.8	4.0	37.8
1962	42.9	3.4	46.3
1963	60.3	5.1	65.3
1964	65.2	4.3	69.5
1965	54.1	9.4	63.5
1966	72.2	26.7	98.9
1967	107.8	40.5	148.3
1968	139.5	57.9	197.3
1969	184.3	65.2	249.5
1970	366.1	79.7	445.7
1971	367.3	63.4	430.7
1972 ⁽²⁾	352.0	83.9	435.9

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

(1) INCLUDES UNITS WITH MORTGAGE INSURANCE WRITTEN FOR ASSISTANCE UNDER THE HOME SECTION 235(i), MULTIFAMILY HOUSING SECTIONS 236, 235(j), BELOW MARKET INTEREST RATE PROGRAMS, AND RENT SUPPLEMENT PROGRAMS NOT ELSEWHERE COUNTED; UNITS FINANCED BY DIRECT LOANS UNDER SECTION 202; LOW RENT PUBLIC HOUSING UNITS WITH ASSISTANCE CONTRACTS EXECUTED; UNITS FINANCED BY INITIAL LOANS OR GRANTS MADE UNDER SECTION 502 LOW AND MODERATE INCOME PROGRAM, AND SECTIONS 515, 521, 514, 516 FAMILY HOUSING PROGRAMS.

(2) PRELIMINARY.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; DEPARTMENT OF AGRICULTURE .

A Department of Agriculture audit of FmHA programs found major problems in some projects, including inadequate water supplies, septic systems, and road development.⁴ Although some of these problems could be alleviated by administrative solutions, it was also apparent that the programs might contain basic structural flaws which would make effective administration impossible.

This chapter presents an assessment of the costs and benefits, the equity and the impact on recipients' welfare of major subsidized housing programs: low rent public housing, the Section 235 homeownership, the Section 236 rental assistance, the rent supplement, the Section 502 interest credit and non-interest credit rural homeownership, and the Section 504 rural home repair assistance programs. The programs are evaluated as national programs; therefore, the data and the results are generalized to the national level, which means that the findings are not always applicable to a specific region, locality or project.

The chapter begins with a discussion of criteria for a nationwide evaluation and then presents the major findings and conclusions. A description of overall program equity, some evidence of social impact, and an analysis of the individual subsidy programs follows. An appendix discusses several special issues.

A technical paper defining the measurement criteria, the processes of measurement, the data bases, and the limitations of the analysis will be published in the near future.

CRITERIA FOR A NATIONWIDE EVALUATION

A thorough and fair assessment of the Federal Government's subsidized housing programs must begin with the selection of an appropriate set of expectations against which to gauge performance. A logical starting point is to identify whom the programs serve and how the programs affect these and other groups. Costs and benefits or, more precisely, the relationship between costs and benefits is also an important

⁴Department of Agriculture, Office of the Inspector General, Review of Farmers Home Administration Activities with Emphasis on the Rural Housing Program, 1973, unpublished.

concern. This section sets forth relevant considerations for judging subsidized housing programs. Every effort has been made to state the issues in a manner which makes statistical analysis both possible and meaningful. All important issues appear to be simple extensions of three basic questions:

1. Equity: Are the subsidized housing programs serving the appropriate people?
2. Impact: Are the programs having the desired effect on those served, and on the community at large?
3. Efficiency: How do the benefits compare to the costs incurred?

For convenience, these concepts will be referred to as equity, impact and efficiency.

Each of the criteria provides a different perspective on the subsidized housing programs. A program should not be judged on the basis of a single criterion to the exclusion of others. In addition, poor program performance with respect to any one criterion should be weighed against the potential of alternative programs to perform better under the same criterion.

EQUITY

Shelter, along with food, clothing, and medical care, is considered a basic necessity of life. The subsidized housing programs evolved from public recognition that adequate housing is not available to all families. Adequate housing is not available in two senses: either a family's dwelling fails to satisfy certain minimal standards of safety and sanitation or the family does have satisfactory housing but at a price which severely limits the family's ability to afford other goods and services, particularly other necessities. Expressed in this way the housing problem is essentially an income problem. A low-income family must either forego satisfactory housing or, if possible, purchase it by doing without the satisfaction of other important needs.

In this chapter the subsidized housing programs will be judged by the extent to which they, singularly and in combination, channel assistance to those most in need, that is, those families with low income. This criterion is consistent with Congressional intent. All the subsidized programs have income limits designed to restrict assistance

to lower income families. The limits vary by program and by area. The Section 235 and Section 236 limits are higher than those for the public housing and rent supplement programs, but there is clear evidence that Congress did not intend for these programs to exclude those with low incomes. The statute requires both programs to be administered in a manner that establishes a preference for families having incomes "within the lowest practicable limits." In 1972, HUD, to protect Section 236 projects from financial difficulties, attempted to limit admission to those families who could afford the rent with an expenditure of less than 35 percent of their adjusted income.⁵ A Federal District Court found this requirement to be inconsistent with the goals of the program.⁶ The Court declared that "the Section 236 program is aimed at lower income families including those eligible for public housing and that the two programs envision substantial overlap." Furthermore, the Court pointed out that HUD was severely criticized at the very outset of the Congressional debates over Section 236 for directing prior housing projects toward moderate rather than lower income families.

This criterion is also in harmony with public opinion. In a recent survey of attitudes toward Federal Government assistance, the public supported governmental help for housing for low-income families by a margin of 68 percent to 12 percent, while rejecting similar assistance to families of moderate income by 59 percent to 27 percent.⁷

The similarity between a family having a housing problem and having low income is not perfect. Area differences in the cost of housing imply that a family income insufficient to afford adequate housing in one locality may be sufficient in another locality. It is possible that market imperfections could make adequate

⁵HUD Circular No. 4442.18.

⁶Findrilakis, et al. v. Romney, U.S.D.C., N.D. Calif., C.A. No. C-72-801 RFP (1973).

Larson et al. v. Romney, et al., U.S.D.C., N.D. Calif., C.A. No. C-71-2429 RFP (1973).

⁷Louis Harris and Associates, Inc., "A Study of Public Attitudes Toward Federal Government Assistance for Housing Low Income and Moderate Income Families," prepared for National Housing Policy Review, Department of Housing and Urban Development, July 1, 1973.

housing available only at excessive prices in some localities so that a family would need a substantial annual income to afford adequate housing. In general, however, a family's level of income is a good indicator of its housing need.

Three measures have been selected to indicate the extent to which the subsidized housing programs, singularly or in combination, provide assistance to low-income families. First, attention is given to the distribution of program recipients by income. One would expect that the majority of recipients would be found in the low-income range and that a relatively small percentage would be found in the higher income brackets. The second measure is the number of families earning less than a certain income who receive no housing assistance from any Federal program. This measure provides an approximate estimate of the unserved need. The third measure is the average subsidy per recipient household at various income levels. One would expect the average subsidy to decline from the lower income brackets to the higher income brackets, particularly if housing assistance is designed to enable families to obtain adequate but not deluxe housing.

There is no clear dividing line between low- and moderate-income. For illustrative purposes \$5,000 was chosen as an arbitrary dividing line between the most needy and those in less need.⁸ However, in order to obtain a full perspective on the equity issue one should consult the tables which accompany the analysis. The conclusions of the chapter with regard to program equity are not significantly altered by reasonable variation in one's choice of a dividing line between those families in most need and those in less need.

The foregoing discussion of equity considers distinctions between income classes on the presupposition that subsidized housing programs should treat people differently depending on their income -- the concept of

⁸A Bureau of Labor Statistics study (Press Release of June 15, 1973) indicates that in 1972 annual renter costs for a family of four on a "lower budget" averaged \$1,205 over the United States. A family with income over \$5,000 annually could afford such a unit with an expenditure of less than 25 percent of income. The BLS "lower budget" renter costs are for a unit which provides more than minimally adequate housing.

vertical equity.⁹ These programs should also provide equal treatment to those who have approximately equal income. This dimension of the equity question is called horizontal equity. In other words, the programs should not provide extensive benefits to one family and no benefits to another family whose income is identical. One special case of horizontal equity, termed geographical equity, concerns whether families in one section of the country have a higher probability of being served than families with identical income in other sections of the country.¹⁰

These various tests of vertical and horizontal equity were performed for each of the subsidized programs and for all five programs combined. The assessment of overall equity is particularly important because the more relevant consideration is how well the programs function together to meet the observed need.

It should be emphasized that almost any housing assistance program, indeed virtually any program of assistance to anyone, will have some inequities. The major question is whether alternative housing programs or alternative policies for addressing the low-income problem will perform better or worse with regard to the equity criteria.

IMPACT

Impact criteria measure whether the subsidized programs have the desired effect on those served and on the community at large. Many separate issues are subsumed under this concept. The subsidized housing programs have a common structure. The recipients are provided housing units, they make payments (either rent or mortgage), and the Government makes subsidy payments on their behalf.

The Federal Government's payment is designed to allow the recipients to receive more housing than their payments

⁹ This assumes that other relevant characteristics are similar, such as family size.

¹⁰ In applying the equity criteria to the programs, it was impossible to adjust for differences in the cost of housing and other goods in various parts of the country.

alone could buy.¹¹ One impact measure, then, is the amount of "extra housing" received by the beneficiary. The difference between the amount paid by a family for a subsidized unit and the market value of that unit (the price it would command on the open market) is the extra housing received by the subsidized family.¹²

A second impact measure is the extent to which the beneficiaries of the subsidy programs, in fact, live in better housing than they would have otherwise. This can be determined by relating the market value of subsidized units to the cost of housing the family would have occupied in the absence of the program. The percentage improvement in the quality of the subsidy recipient's housing can be derived from this relationship. If one assumes that low-income households have very little or nothing to put into savings, then the percentage change in expenditures on goods and services other than housing can also be derived.

The special emphasis placed on housing by society, in part, reflects society's expectation that better housing benefits the occupants in important ways such as improved health, greater family stability, better school performance by children, etc., or benefits society in terms of lower crime rates, achieving racial or economic integration, or other societal goals. A special section of this chapter will review existing research and other information on the social impact of better housing.

Another impact issue concerns the extent to which the welfare of the average family is increased by participating in the subsidized housing programs. The five programs studied all provide benefits in-kind rather than in-cash. In other words, the family is given a unit rather than money. With an unrestricted cash grant, the family could

¹¹It is useful to picture a housing unit as providing a quantity of housing services. These services depend on the size of the unit; its amenities, such as whether it has air conditioning; its design; and its location. The more amenities or the better the location, the more housing services provided by the unit. In comparing the quantity of housing services provided by two different units, it is possible that the poorer location of one may be offset by a larger number of amenities.

¹²This assumes a competitive housing market.

choose that particular housing, or the combination of housing and other goods, which it most prefers. Under the subsidized housing programs, the family has a much narrower range of choice. It is useful to determine the extent to which this constraint tends to decrease the value of the subsidy to the family. One way to measure this effect is to estimate what cash grant the family would accept in lieu of participation in the subsidy program. This cash grant represents the actual dollar benefit to the recipient of the subsidy he receives through the program.

EFFICIENCY

Efficiency criteria measure the relationship of benefits to costs. If benefits are high relative to costs, the program is efficient and vice versa. There are several possible efficiency measures, depending on the cost or benefit concepts utilized. In general, the measurement of costs cannot be limited merely to the Federal Government's direct subsidy payment but must also include any other costs incurred by Government as a result of the program -- for example, administrative costs, taxes forgone, default costs exceeding mortgage insurance premiums, and any special Government interest rate subsidies. In this evaluation, an efficiency measure of 1.0 means that the total Government costs are transformed into benefits of equal magnitude. A measure less than 1.0 means the benefits are less than the costs. For example, an efficiency measure of .75 means that \$1 of total Government cost produced 75 cents worth of benefits.

One important efficiency measure is how the extra housing provided under the program -- the difference between what the family would have to pay for an unsubsidized unit and the amount paid for a similar subsidized unit -- relates to the costs incurred by the Government in providing the extra housing. This ratio is defined as Production Efficiency, i.e., the ratio at which the Government transforms tax dollars into extra housing.

Production Efficiency depends upon several factors. One is the cost of construction. If the prices paid for Government subsidized construction are higher than those paid by conventional builders, then Production Efficiency will be low. The relationship between the total development cost of a project built conventionally and an identical project built through Government subsidy programs is a measure of Construction Efficiency.

Housing consists of more than just structure. Location, design, financing, and operating costs all enter into total costs as well. The price paid by occupants and all levels of government for construction, operation, and all other cost factors involved in a housing unit divided into the price of a similar unit in the private market is a measure of Technical Efficiency.

It was noted in the section on impact that the tenant may not value his extra housing as highly as its market price because the in-kind nature of the transfer restricts his flexibility in choosing between various housing options and other goods. The value to the tenant can be measured by the size of the unrestricted cash grant which he would accept in lieu of the subsidy. The ratio of this cash grant to the market value of the subsidy (the extra housing provided) is defined as Transfer Efficiency.

Transfer Efficiency is calculated in this study by comparing how subsidy recipients spend their income after receipt of the subsidy with how they spent their income before they entered the program and then estimating through statistical techniques how much the subsidy added to their overall economic well-being. The measure is based on observing consumer behavior rather than a program participant's subjective evaluation of the cash value of the housing subsidy.

Transfer Efficiency will almost always be less than one for programs that provide subsidies-in-kind instead of unrestricted cash grants. Furthermore, the particular statistical estimation technique utilized will produce an estimate less than one. Nevertheless, from the subsidy recipient's viewpoint, the higher the numerical value of the measure, the more efficient the program.

An overall efficiency measure is the ratio of the increase in the occupant's welfare measured in terms of an unrestricted cash grant to the total costs incurred by Government to achieve that increase in welfare. This measure is defined as Program Efficiency.

If Program Efficiency is considerably less than one, the program may still be a worthwhile Government expenditure. Although Program Efficiency is determined from the viewpoint of the subsidy recipient, the taxpayer may have other reasons why he desires the recipient to have better housing (e.g., new subsidized housing may stabilize declining neighborhoods

or some members of society may simply achieve satisfaction because some low-income families are living in better housing than they would otherwise).¹³

Similarly, there may be costs in addition to the measurable governmental costs. Some of these costs are simply redistributational, that is, one person's gain is exactly counter-balanced by another's loss. If Federal construction should raise construction wages throughout an area, new home buyers would be hurt while construction workers would be helped. Other costs represent a net loss to society. An example would be overcrowding of school facilities by the introduction of a large federally subsidized project into a neighborhood.¹⁴

If one could measure all of these costs and benefits, then a comparison could be made of total program benefits received by occupants and others to total program costs. This ultimate measure could be termed Social Efficiency. However, Social Efficiency is inherently unquantifiable. What can be said, nevertheless, is that if Program Efficiency has a value significantly less than 1.0, then the social benefit of the program must be extensive to justify it, or policy makers should seek more efficient ways of achieving their objectives.

PROGRAM VIABILITY

Although equity, impact, and efficiency embrace almost all relevant considerations in the evaluation of the subsidized housing programs, there is another important issue. Subsidized housing programs must be economically viable. If, given the intended level of occupant rents or mortgage payments, the subsidies established by the programs are insufficient to cover all housing costs, then the project will necessarily become bankrupt or the single-family mortgagor will be unable to make the required payments. This will prematurely terminate the benefits provided by the unit and may impose additional unanticipated costs on

¹³Stimulation of the economy is sometimes given as a justification for the programs. This position is discussed in the "Stimulating the Economy" section in the Appendix.

¹⁴The term "externalities" is frequently used by economists to describe such effects because the costs or benefits are experienced by those external to the activity.

the Government. Experience with present and similar past programs was used to predict the possible magnitude of this problem.

INTERPRETATION OF RESULTS

In using the analyses that follow, readers should be cautioned that almost every statistic is based either on sample data or computer simulations. Simulations reported are based on our best judgment of reasonable assumptions. Different assumptions could lead to different numerical values. Accordingly, the statistics should be viewed as approximations. In the parlance of statisticians, there is a high probability that the true value lies within a narrow range of the estimated value. A technical appendix to be published will set forth in detail the assumptions on which these estimates rest and precisely how they were derived.

MAJOR FINDINGS AND CONCLUSIONS

The first part of this section mainly describes the impact of the subsidy programs. The next part presents the benefits in relation to the costs and an analysis of equity aspects of the programs. The third part contains conclusions based primarily on the individual program analyses contained in later parts of the chapter.

IMPACT

A total of almost 2.8 million dwelling units have been provided since 1937 through Government subsidized housing programs for low- and moderate-income families. Many beneficiaries of housing subsidy payments were previously housed in substandard housing, or paying excessively high rent relative to their incomes in standard housing. Table 4 provides indicators of some of the impacts of the subsidized housing programs, and the following is a summary of these impacts:

1. The improvement in the housing of recipients ranged from a high of 92 percent for the beneficiaries of the Section 502 rural homeownership interest-credit program, to 35 percent for the recipients of Section 235 homeownership dwellings. The improvement in

TABLE 4

ESTIMATED IMPACT OF SUSIDIZED HOUSING PROGRAMS*

IMPACT (AVERAGE)	LOW RENT PUBLIC HOUSING	236	RENT SUPPLE- MENT	235	502 INTEREST CREDIT	502 NON- INTEREST CREDIT	504
PERCENTAGE IMPROVEMENT IN RECIPIENTS' HOUSING	75	51	NA	35	92	57	54
PERCENTAGE INCREASE IN EXPENDITURES ON OTHER GOODS	14	0	NA	8	-3	-7	-9
ANNUAL BENEFIT TO EACH RECIPIENT HOUSEHOLD	\$708	\$526	\$696	\$857	\$567	\$30	NA
ANNUAL DIRECT SUBSIDY TO EACH RECIPIENT HOUSEHOLD	\$702	\$956	\$1,300	\$948	\$695	\$92	\$75
ANNUAL TOTAL GOVERNMENT COST FOR EACH RECIPIENT HOUSEHOLD	\$1,650	\$1,100	\$1,477	\$1,087	\$813	\$190	NA
ANNUAL BENEFIT AS PERCENTAGE OF INCOME	22	10	26	13	10	LESS THAN ONE HALF	NA
ANNUAL DIRECT SUBSIDY AS PERCENTAGE OF INCOME	21	18	49	14	12	1	3

NA = NOT AVAILABLE.

* 236, RENT SUPPLEMENT, AND 235 DATA ARE FOR 1972. 502 AND 504 DATA ARE FOR FISCAL YEAR 1972. LOW RENT PUBLIC HOUSING DATA ARE FOR 1971 AND INCLUDE ALL METHODS OF PROVIDING PUBLIC HOUSING.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

housing is the difference between the value of housing occupied under the program and the value of housing that would have been occupied in the absence of the program.

2. Increased expenditures on non-housing goods and services as a result of the housing subsidies ranged from a high of 14 percent for recipients of public housing, to a minus 9 percent for recipients of the Section 504 homeownership repair program. In each of the FmHA programs analyzed, expenditures on other goods declined, indicating that the subsidy programs induced households to spend more of their own income on housing than previously.
3. The annual benefit measures the value in unrestricted cash of the extra housing which the subsidy has provided to the recipient. The annual benefit ranged from a high of \$857 for the beneficiaries of the Section 235 homeownership program, to \$30 for those receiving a Section 502 non-interest credit subsidy.
4. The annual benefit as a percentage of income ranged from a high of 26 percent for beneficiaries of the rent supplement program to little change for Section 502 non-interest credit participants.
5. About 60 percent of the subsidized units were provided to families having annual incomes of less than \$5,000. The low rent public housing program served the great majority of these recipients.
6. Minority families were served by the housing programs to a considerably greater degree -- as a percentage of total eligible -- than other low- and moderate-income families.
7. There is some evidence that Government subsidized housing programs increase opportunity for the geographical dispersion of central city inhabitants, particularly minorities, to suburban areas. There is also some evidence that the programs contribute to racial balance within some communities. However, the potential contribution of subsidized production is limited inasmuch as even in the years of highest production, subsidized housing accounted for only about 5 percent of the total new and existing housing stock marketed.

8. Almost 7 of every 10 households in the public housing and rent supplement programs are female-headed. Female-headed households are more likely than male-headed households to be poor and are generally subject to discrimination in the housing market.
9. The FmHA has provided access to credit for housing purchases and home repair for many families in rural areas which has improved the housing of low- and moderate-income households.
10. The Section 235 and Section 502 homeownership programs have enabled a number of low- to moderate-income families who desire to own homes to achieve their objective. Nationally, only a third of homeowners have annual incomes below \$7,000; almost two of every three beneficiaries of these programs have incomes below that level.

EFFICIENCY, COSTS, AND EQUITY

The impact of the Government subsidized housing programs is achieved at the cost of serious program inefficiency and inequity. The costs of the accomplishments are greater than the benefits, including the observable benefits to society. Improvements are possible through administrative changes but substantial inefficiencies and inequities are inherent in the programs. A summary of efficiency and equity problems is presented below:

1. Production Efficiency is the ratio of the market value of the extra housing provided under the program to the total costs incurred by Government in providing the extra housing. The Production Efficiency of the subsidized housing programs ranges from a high of .87 for the Section 235 homeownership program, to .48 for the Section 502 non-interest credit program.
2. Construction Efficiency is the ratio of the total development costs of a project built conventionally to the total development costs of an identical subsidized project. For every \$1 of total development cost for a Section 236 project only 83 cents would be spent for an identical project in the private sector. Part of this difference represents the cost of special Government requirements, such as construction standards, affirmative action and environmental clearance. Special financial and builder inducements and higher wage rates also play a role.

TABLE 5

**MEASURES OF EFFICIENCY IN GOVERNMENT
SUBSIDIZED HOUSING PROGRAMS⁽¹⁾**

SUBSIDY PROGRAM	PRODUCTION EFFICIENCY	CONSTRUCTION EFFICIENCY	TECHNICAL EFFICIENCY	TRANSFER EFFICIENCY	PROGRAM EFFICIENCY
LOW RENT PUBLIC HOUSING	.74	NA	.85	.75	.55
236	.70	.83	NA	.71	.50
236 RENT SUPPLEMENT	.84	.83	NA	.64	.54
RENT SUPPLEMENT	.75	.83	NA	NA	.48 ⁽²⁾
235	.87	1.00	.94	.90	.79
502 NON-INTEREST CREDIT	.48	1.00	.94	.33	.16
502 INTEREST CREDIT	.85	1.00	.94	.82	.70
504	NA	NA	NA	NA	NA

NA = NOT AVAILABLE.

(1) 236, RENT SUPPLEMENT, AND 235 DATA ARE FOR 1972. 502 AND 504 DATA ARE FOR FISCAL YEAR 1972. LOW RENT PUBLIC HOUSING DATA ARE FOR 1971 AND INCLUDE ALL METHODS OF PROVIDING PUBLIC HOUSING.

(2) DERIVED BY ASSUMING THAT TRANSFER EFFICIENCY IS THE SAME AS THAT FOUND IN THE 236 RENT SUPPLEMENT PROGRAM.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

3. Technical Efficiency compares the cost of providing housing in the private market with the full cost of providing it under a Government program. Here, the term "cost" refers to both construction and operating costs. Technical Efficiency ranged from a high of .94 for the Section 235 and Section 502 programs, to a low of .85 for low rent public housing.
4. Transfer Efficiency measures how much the recipient values the housing assistance provided by the Government relative to its market value. A ratio of less than 1 indicates that the recipient would prefer an unrestricted cash grant of an amount smaller than the market value of the housing subsidy. The Transfer Efficiency ranges from a high of .90 for the Section 235 homeownership program to .33 for the Section 502 non-interest credit homeownership program. (Reasons for the low efficiency of this program are discussed below.)
5. Program Efficiency is a measure of the overall efficiency of each program from the recipient's viewpoint. The effects of Construction Efficiency, Production Efficiency and Transfer Efficiency are all reflected in this measure. Program Efficiency ranges from a high of .79 for recipients of the Section 235 program, to .16 for recipients of the Section 502 non-interest credit program. The program having the next lowest Program Efficiency is the rent supplement program with .48. This means that for the rent supplement program about 52 cents of every \$1 spent by Government does not increase the occupant's welfare (from the occupant's viewpoint).
6. The Section 236, rent supplement, and Section 235 programs all evidence substantial problems of failure as reflected in mortgage assignments to HUD and foreclosures. The cost of such failures is reflected in the foregoing efficiency measurements.

Approximately 30 percent of all Section 221(d)(3) market interest rate rent supplement projects, and 20 percent of all Section 236 projects are projected to fail during their first 10 years.

Rapid decay of Section 235 units in some neighborhoods, or financial setbacks suffered by owners, often leads to abandonment, defaults and foreclosures. It is currently projected that about 16 percent of all

Section 235 units will fail during their first 10 years. Although the insurance fund for the Section 235 program was actuarially sound through 1972, recent foreclosure rates for Section 235 units are above actuarial expectations.

FmHA programs, on the other hand, experience comparatively low foreclosure costs, but those savings are offset by FmHA's relatively high administrative costs.

7. Evidence indicates that most subsidized housing starts replace private housing starts. However, the groups that would have been served by unsubsidized private construction would differ in most instances from those served by subsidy programs. Moreover, the location of the units would often have been different.
8. Subsidized housing has not provided significant indirect benefits by opening up better unsubsidized housing at the same or less cost than tenants were previously charged. In studies of the "housing filtration" process performed for this report, families moving into dwellings vacated by those moving into subsidized units usually moved into better quality housing, but also paid higher rents than they had paid previously. Under these circumstances, it is unclear whether filtration lowered the cost of housing to the nonsubsidy recipients.

The fact that a family moved into a unit vacated by a subsidy recipient does not in itself establish that there are indirect filtration benefits because:

- . the family might have moved into another unit in the absence of the program,
 - . the subsidized housing programs probably provide few net additions to the housing stock, and
 - . even if there were short run drops in housing costs or rents for units vacated by subsidized families, these would probably be offset by long term declines in housing quality.
9. The subsidy programs have relatively small budget impact in the year funds are committed for housing units. However, the programs commit the Federal Government to a relatively high level of "run-out costs" over a program's life -- up to 40 years in some instances.

These include both direct Government payments and some indirect costs such as forgone taxes. Table 6 presents estimated run-out costs of the housing subsidy programs for commitments through Fiscal Year 1973. The table also shows run-out costs discounted at 5 percent and 7.5 percent. A discount rate expresses the present value of costs which will be incurred in future years.

10. Combined, the subsidy programs have, to date, provided a slightly greater probability of serving low-income than higher-income families. However, more than one-third of all subsidized units, or almost 700,000, provide services to households earning more than \$5,000 annually. At the same time, over 16 million households with annual incomes of less than \$5,000 -- about 94 percent of the total households in this income category -- receive no assistance whatsoever.
11. The great majority of households at each income level is not served. Moreover, a household's geographical area of residence significantly affects its chances of obtaining subsidized housing. This kind of inequity would be reduced by the production of more subsidized units.
12. The total Government cost of the subsidized housing programs (about \$2.5 billion in calendar year 1972) was about \$1.1 billion greater in 1972 than benefits received by recipients (Table 7). The benefits shown in Table 7 are measured in terms of the cash grant the family would accept in lieu of participation in the subsidy program.

A way to account for some of the inefficiency measured in this manner (i.e., excess of total Government costs over the benefits as viewed by the recipients) is that some of these costs are offset by benefits to nonsubsidy recipients.

CONCLUSIONS

Government subsidized housing programs contain structural problems that result in considerable program inequities and inefficiencies. Certain problems could be remedied through legislative changes. However, legislative correction of one problem would often tend to aggravate or create others. More importantly, while administrative changes would marginally improve the

TABLE 6

ESTIMATED RUN-OUT COSTS OF SUBSIDIZED HOUSING

(DOLLARS IN BILLIONS)

PROGRAM	TOTAL	TOTAL DISCOUNTED AT 5%	TOTAL DISCOUNTED AT 7 1/2%
235	\$2.5	\$2.1	\$1.9
236	14.0	8.0	6.0
RENT SUPPLEMENT	8.0	3.0	2.0
LOW RENT PUBLIC HOUSING	58.3	25.9	19.4
502	2.9	1.6	1.3
TOTAL	\$85.7	\$40.6	\$30.6

NOTE: BASED ON ESTIMATED NUMBER OF UNITS WITH CONTRACT COMMITMENTS THROUGH FISCAL YEAR 1973, EXCEPT LOW RENT PUBLIC HOUSING, WHICH IS BASED ON JUNE 1973 ESTIMATES OF COMMITMENTS THROUGH FISCAL YEAR 1974. THESE INCLUDE ALL METHODS OF PROVIDING PUBLIC HOUSING.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

TABLE 7

EXCESS OF COSTS OVER BENEFITS TO RECIPIENTS, 1972

(DOLLARS IN MILLIONS)

PROGRAM	TOTAL ESTIMATED GOVERNMENT COSTS	TOTAL BENEFITS TO RECIPIENTS	EXCESS COSTS
LOW RENT PUBLIC HOUSING	\$1,609	\$885	\$724
236	120	60	60
236 RENT SUPPLEMENT	44	23	21
RENT SUPPLEMENT	124	60	64
235	404	319	85
502 NON-INTEREST CREDIT	85	14	71
502 INTEREST CREDIT	91	64	27
TOTAL	\$2,477	\$1,425	\$1,052

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF AGRICULTURE.

efficiency and equity of production programs, serious problems of inefficiency and inequity inherent in using production as the basic approach would remain.

Existing programs require the construction of new or substantially rehabilitated units. Thus, where existing decent older housing is available, programs diverting lower-income families to new and better housing require a larger per family subsidy than a strategy which emphasizes greater use of the existing stock.

Evidence indicates that the average low rent public housing unit is as good as the average unit available for rent in the private sector. In both the Section 236 and the rent supplement programs, units are substantially better than the average existing private sector unit. Most program beneficiaries could be well-served by a less-expensive unit in the existing housing stock or a cash transfer of lesser value than the current subsidy. Although these families would not have housing of as high a quality as under a production program, the objective of a "decent home" would be met in most cases. Most importantly, the lower cost per family would allow the Government within a given budget to make available better housing for more low-income families.

The production programs, except for low rent public housing, depend primarily upon the initiative of private builders and sponsors. Profit inducements must be provided to insure that participation is forthcoming. The inflexibility of the system means that the same opportunities for profit are given to sponsors serving the suburban elderly as to those serving the ghetto poor. However, building greater flexibility into the incentive system would be extremely difficult if not impossible.

Other characteristics of Government production programs that may result in higher costs (reduced efficiency) include affirmative action activities and environmental considerations and probably higher wage costs. These factors increase society's well-being but at the cost of reduced Program Efficiency viewed from the more narrow standpoint of assistance to the occupant of the subsidized housing.

Increasing the amount of subsidy for beneficiaries -- "deepening the subsidy" in other words -- would allow the programs to serve the more needy, but within the framework of a production assistance strategy, these modifications would entail trade-offs with other aspects

of program performance. Increasing the number of beneficiaries from the present low proportion of eligibles served would also entail trade-offs.

Deepening the subsidy or increasing the number of beneficiaries would result in the following trade-offs:

1. The cost of the programs to Government and losses through inefficiency would rise substantially.
2. The failure rate (i.e., assignments and foreclosures) might well rise because generally speaking the lower the income of the recipient the greater the risk.
3. Local opposition would likely increase as more sites would be required, particularly in suburban areas. Notwithstanding current efforts toward de-concentration, this could lead to concentration of projects as well as to large projects located on poor site locations -- better housing but in a less desirable living environment.
4. Greater concentration of the very poor in each multi-family project may well lead to higher operating costs and emphasize the negative image of Government subsidized housing projects, thereby reinforcing local opposition.

Legislative changes to improve the efficiency of programs could include modification of tax incentives for private enterprise, but predicting in advance of field experience the nature and extent of the inducements required to draw in private enterprise is very difficult and differs, as previously noted, by location, tenant characteristics, and national and local economic situations. Substitution of Federal for private lending might decrease direct costs, but the impact of increased Federal borrowing on overall interest rates and debt payments on Federal borrowings as a whole could offset this gain. Although elimination of administrative determination of wage rates might reduce costs in some cases, gains in Program Efficiency through cessation of administratively determined wage rates would be relatively minor, given the inherent structural problems in the programs.

OVERALL PROGRAM EQUITY

Although the subsidy programs have somewhat different and overlapping target groups, nevertheless it appears to be Congressional intent that taken as a whole these programs should serve equitably the housing needs of lower-income households. This section analyzes how equitably the programs actually have served lower-income households. The analysis includes the following programs: low rent public housing, rent supplement, the Section 235 homeownership, the Section 236 rental assistance, the Section 502 interest credit rural homeownership, and the Section 504 rural housing repair programs.

Under most circumstances only families or elderly individuals can occupy federally subsidized housing; single individuals under 62 are excluded by law. Table 8 computes the number of eligible households by income level by adding persons over 62 living away from their families to the Census count of families. For the purposes of presenting the analysis, \$5,000 was selected as a dividing line between low- and moderate-income.

There are almost 18 million households with incomes less than \$5,000 a year of which 15.5 million are considered as eligible households. Some of these households, through their own efforts or because of Federal, State or local housing subsidy programs, have decent housing at a 25 percent or less shelter cost-to-income ratio. However, in 1970, half of the eligible households earning under \$5,000 lived in overcrowded conditions, paid more than 25 percent of their income for rent, lacked adequate plumbing, or occupied very old low-cost units.

Table 9 shows the total number of households served by the subsidized housing programs and the percent of total households served. Combined, the subsidy programs provide a slightly higher probability of serving low-income than moderate-income households.

The distribution of benefits within any income level is uneven. Furthermore, most low-income households are not being served. Only 349,000 (about 6 percent) of 5.6 million households with incomes less than \$2,000 are served. Similarly, about 4.0 million households out of 4.3 million earning between \$2,000 and \$3,000 annually receive no housing subsidy.

TABLE 8

ESTIMATED HOUSEHOLDS ELIGIBLE FOR PARTICIPATION IN SUBSIDIZED HOUSING PROGRAMS AS OF DECEMBER 31, 1972

GROSS INCOME	TOTAL HOUSEHOLDS	ELIGIBLE * HOUSEHOLDS
\$0 - 999	1,800,000	1,500,000
1,000 - 1,999	3,800,000	3,400,000
2,000 - 2,999	4,300,000	3,900,000
3,000 - 3,999	4,000,000	3,400,000
4,000 - 4,999	3,800,000	3,300,000
5,000 - 5,999	3,800,000	3,100,000
6,000 - 6,999	3,600,000	3,100,000

* INCLUDES ALL FAMILIES AND ELDERLY UNRELATED INDIVIDUALS. EXCLUDES INDIVIDUALS UNDER 62 WHO LIVE AWAY FROM THEIR FAMILIES. DOES NOT TAKE ACCOUNT OF INCOME LIMITS OR OTHER PROGRAM ELIGIBILITY REQUIREMENTS.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NUMBERS 83, 84, 87, AND 1970 CENSUS OF POPULATION.

TABLE 9

**DISTRIBUTION OF HOUSEHOLDS SERVED BY RENT SUPPLEMENT, LOW RENT PUBLIC HOUSING,
SECTIONS 235, 236, 502 INTEREST CREDIT, AND 504, BY INCOME CLASS, AS OF DECEMBER 31, 1972**

GROSS INCOME	HOUSEHOLDS SERVED	TOTAL HOUSEHOLDS	HOUSEHOLDS SERVED AS PERCENT OF TOTAL HOUSEHOLDS
\$0 - 999	29,000	1,800,000	2%
1,000 - 1,999	320,000	3,800,000	8
2,000 - 2,999	293,000	4,300,000	7
3,000 - 3,999	244,000	4,000,000	6
4,000 - 4,999	230,000	3,800,000	6
5,000 - 5,999	230,000	3,800,000	6
6,000 - 6,999	198,000	3,600,000	5
7,000 - 9,999	227,000	11,200,000	2
10,000 OR MORE	25,000	32,300,000	LESS THAN .5%
TOTAL	1,795,000	68,500,000	3%

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

THIS TABLE IS NOT EXACTLY COMPARABLE TO TABLES 10 AND 12 BECAUSE OF DIFFERENCES IN PROGRAM COVERAGE OR YEAR OF CENSUS DATA.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES
BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF
AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION
REPORTS, SERIES P-60, NOS. 84 AND 87, AND 1970 CENSUS OF POPULATION.

Much of the inequity is inherent in the structure of the programs. An important reason for inequity is that the subsidies allowed, except in low rent public housing and the rent supplement program, are not deep enough to serve most low-income families. These families are excluded because they simply cannot pay the minimum rents required for subsidized units at reasonable rent-to-income ratios.

Second, the programs, in accordance with the statutes, rely principally on new construction or substantial rehabilitation. They are not keyed toward maximum use of the existing stock of housing, which would be less expensive. Therefore, a relatively few households receive high quality units and no housing subsidies are given to the remaining lower-income population. Greater use of the existing housing would allow more low-income families to be served with the same expenditure of Government funds.

A third structural cause of the unequal distribution of assistance in the various programs is that low cost units cannot exist in some localities because of zoning or other restrictions. Moreover, low rent public housing and rent supplement units require specific local approval.

Fourth, since builders' profits, professional fees, and tax incentives depend on the total development cost, there is an incentive to maximize this cost. To the extent this results in more expensive units, fewer families are able to afford them.

In an effort to maintain the financial solvency of projects and to respond to the recommendations of experienced managers, HUD has published regulations requiring a "cross-section" of tenants to be admitted to many of its rental projects. However, this policy has meant fewer very low-income tenants can be served.

A special aspect of the unequal distribution of assistance within similar income groups is the fact that a household's geographic place of residence significantly affects its chances of obtaining subsidized housing. Table 10 shows for two different income levels the percent of each region's households receiving subsidized housing. At both these levels, a family in the South has a much greater chance of being served than a family of equal income elsewhere. In the Far Western, Mountain, Plains, and Middle Atlantic States, families at each income level have less than an average chance of being served. The results are similar for other income levels.

TABLE 10

**PERCENT OF HOUSEHOLDS SERVED BY SUBSIDIZED HOUSING FOR
SELECTED INCOME RANGES, BY HUD REGION, AS OF DECEMBER 31, 1972**

HUD REGION	GROSS INCOME	
	\$1,000-1,999	\$5,000-5,999
I	7%	5%
II	7	5
III	6	4
IV	10	10
V	8	4
VI	9	8
VII	4	3
VIII	5	6
IX	2	5
X	7	6
TOTAL	7%	6%

NOTE: SUBSIDIZED HOUSEHOLDS ARE AS OF DECEMBER 31, 1972. TOTAL HOUSEHOLDS ARE AS OF THE 1970 CENSUS. THIS TABLE IS NOT EXACTLY COMPARABLE TO TABLES 9 AND 12, BECAUSE OF DIFFERENCES IN PROGRAM COVERAGE OR YEAR OF CENSUS DATA. THE STATES AND TERRITORIES ARE INCLUDED IN HUD REGIONS AS FOLLOWS:

- I CONNECTICUT, MAINE, MASSACHUSETTS, NEW HAMPSHIRE, RHODE ISLAND, VERMONT.
- II NEW JERSEY, NEW YORK, PUERTO RICO, VIRGIN ISLANDS.
- III DELAWARE, DISTRICT OF COLUMBIA, MARYLAND, PENNSYLVANIA, VIRGINIA, WEST VIRGINIA.
- IV ALABAMA, FLORIDA, GEORGIA, KENTUCKY, MISSISSIPPI, NORTH CAROLINA, SOUTH CAROLINA, TENNESSEE.
- V ILLINOIS, INDIANA, MICHIGAN, MINNESOTA, OHIO, WISCONSIN.
- VI ARKANSAS, LOUISIANA, NEW MEXICO, OKLAHOMA, TEXAS.
- VII IOWA, KANSAS, MISSOURI, NEBRASKA.
- VIII COLORADO, MONTANA, NORTH DAKOTA, SOUTH DAKOTA, UTAH, WYOMING.
- IX ARIZONA, CALIFORNIA, HAWAII, NEVADA, AMERICAN SAMOA, GUAM, TRUST TERRITORY OF THE PACIFIC ISLANDS.
- X ALASKA, IDAHO, OREGON, WASHINGTON.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION.

The reasons for geographical inequity are different for the different programs. For certain programs, the combination of high construction costs and low mortgage limits reduce building within a particular area. Low rent public housing has been limited in the Plains and Mountain States by a lack of local housing authorities. Another cause of geographic inequity in the programs is that some parts of the country have not had many private developers using the programs.

SOCIAL IMPACT

An underlying purpose of Government subsidized housing is to improve the social conditions not only of the poor but also of the communities in which they live.

WHAT IS SOCIAL IMPACT?

Social impact is important, but by its very nature it tends to be difficult to measure. Basically, it involves the question of how communities and neighborhoods and their inhabitants are influenced and affected by the provision of better housing for the poor. The social impact of better housing may be divided into two categories:

1. Direct or "first order" effects upon the occupants of subsidized housing. Improved housing may modify the characteristics of the occupants. Thus, in assessing the direct effects, such questions as these may be asked: Does improved housing increase family stability? Does better housing improve the mental and physical health of the occupants? Do the occupants show a greater incentive to provide for themselves and improve their economic status? Do their children manifest a greater security and willingness to advance in schooling?
2. Indirect or "second order" effects upon a community. Does improved housing reduce crime rates, lower welfare rolls, raise educational levels? Do communities become more stable? Does the improved housing for the poor have the effect of raising property values in adjacent areas?

DIRECT AND INDIRECT IMPACT

There is a relationship between the direct, first-order effects of improved housing and the indirect, second-order effects. The first-order effects are felt primarily by the recipients of the improved housing. To the extent that the physical environment is improved, subsidized housing obviously has had an important social impact. In turn, the community may feel some direct benefits and effects from the improved housing. In terms of social cohesiveness, a community may feel better off, because its poor are better housed.

The impact of improved housing upon a community, however, derives chiefly from indirect or second-order effects. For example, improved housing may reduce rodent infestation. To that extent, the community benefits through the better health of its citizens. Moreover, if improved housing increases family stability or physical health, a community will benefit through reduced costs for welfare and health care. Similarly, society benefits if improved housing leads to less crime, less juvenile delinquency, less drug addiction, improved educational achievement in the schools, or increases in property values.

In judging the social impact of subsidized housing, however, it is also necessary to show that the improved conditions result from better housing and not from other factors. This is not an easy causal relationship to prove or disprove. The improved conditions in one section of a community may result from the characteristics of the families drawn to subsidized housing. In that event, the improved housing may merely lead to the transfer of conditions from one location to another in a community. Similarly, the improved conditions may result from other factors, such as improved police protection, better health care, or community services other than housing.

SUMMARY OF SELECTED CASE HISTORIES ON THE SOCIAL IMPACT OF HOUSING

The most comprehensive study of the impact of housing on the welfare of people was performed in Baltimore in 1962 by Daniel M. Wilner, Rosabelle Price Walkley, Thomas C.

Pinkerton, and Matthew Tayback.¹⁵ Groups of poor people from slum areas, some of whom moved into public housing (test group) and some of whom stayed in slum housing (control group), were compared over time. The purpose of the study was to evaluate the first-order effects of improvements in housing conditions on health; on behavior, attitudes and psychological characteristics; and on children's school performance.

The study indicated that subsidized housing provided few social benefits. Illnesses among the families in the test group were only slightly reduced and little difference between groups was noted in the level of aspirations. The school performance of children in the test group was only marginally improved. This small improvement was attributed to fewer accidents and fewer days of illness because of the better housing. In general, persons over 35 years of age experienced very few social benefits. Rehoused families did, however, significantly increase interactions with neighbors. These minimum first-order effects indicated that other households in the neighborhood were unlikely to benefit from the improvement of housing for the few assisted households.

There have been several studies which attempt to determine whether improvements in housing produce second-order benefits. These studies, for example, have attempted to measure the effect on property values of new housing projects. Property values of subsidized housing and neighboring sites were studied over time. Unexplained changes in property values -- what people were willing to pay to live in a certain area -- were used as an indicator of social impact. If changes in property values could not be related to inflation, direct property improvements or other factors, they could be attributed to the market value of social impact.

One study compared the trends in prices of property located in a ring two to three blocks wide surrounding three public housing projects in St. Louis with three con-

¹⁵Daniel M. Wilner., et al., The Housing Environment and Family Life, Baltimore: Johns Hopkins Press, 1962. For a thorough review of the evidence regarding the impact of housing on health, see Stanislav V. Kasl, "Effects of Housing on Mental and Physical Health," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

trol neighborhoods for the period spanning 1937 to 1959.¹⁶ The three public housing areas contained eight public housing projects. The time span began before the public housing was constructed and ended after completion of the last project. The study found no significant difference in the indices of property value in each of the public housing and control areas, except for one year, over the period.

Another study compared the trends in value of houses around a newly built Section 221(d)(3), below market interest rate project, with trends in a control area without subsidized housing.¹⁷ Both the test and control areas were located in Los Angeles and included mainly white middle-income families. The housing project consisted of 132 units built prior to 1965. The study found that the impact of the project on property values in the immediate area was insignificant. The study adjusted for the socio-economic class of the occupants of the project because they were the same in the test and control areas. Thus, these findings reflect the impact, or lack of it, of the project itself, and are free of the effects that class mixing may cause.

These studies indicate that the introduction of subsidized housing into a neighborhood does not appear to affect property values. Thus, to the extent that change in "property value" is an indicator of the market's perception of social impact, subsidized housing has not been shown to have significant second-order effects. This does not mean there are no spill-over effects from housing. It is possible that a large-scale, sustained rebuilding effort would raise property values.

PUBLIC REACTION TO SUBSIDIZED HOUSING

Because of its intangible and often indirect effects, it is difficult to prove or disprove that subsidized housing is having a desirable social impact. Ultimately, the answer must rest upon the collective judgment of the community affected and the reaction of individual citizens. In this respect, the evaluation of the social effects of improved housing is greatly complicated by the adverse public reaction that often follows the introduction of Government subsidized housing into a community.

¹⁶Hugh Nourse, "The Effect of Public Housing on Property Values in St. Louis," Land Economics, November 1963.

¹⁷Robert Shafer, "The Effects of BMIR Housing on Property Values," Land Economics, August 1972.

Government subsidized housing has acquired a poor reputation in many communities, particularly in suburban areas, where it is often perceived as a negative social influence, lowering educational and property values and transplanting the social problems of the inner cities. To many, subsidized housing represents the intrusion of the Federal Government into the affairs of local communities. Government subsidized housing also is viewed as a potential social burden because it may overload schools, highways, sewage facilities and other community services.

To these negative collective reactions of a community must be added an individual reaction that there is inherent inequity in subsidized housing. The individual reactions come primarily from some who are somewhat better off economically than those who benefit from subsidized housing. They claim inequity because they are faced with living side-by-side with individuals, who, because of Government subsidies, pay less for equivalent (and in some cases newer or even better) housing.

Real or perceived inequities are probably inevitable in a subsidy program for housing. An "inequity" to one family may be a "salvation" to another. The problem for the Government is to weigh the equities -- or inequities -- and come up with a solution that best benefits society.

IMPACT OF SUBSIDIZED HOUSING PROGRAMS ON PATTERNS OF RACIAL MIXING

The legislative history of the Housing Act of 1968 provides little insight as to how the Congress intended the new subsidized housing programs to affect racial mixing. The preamble to the 1968 Act defined its purpose to be:

"to assist in the provision of housing for low- and moderate-income families and to extend and amend laws relating to housing and urban development."

Section 223(e) of the National Housing Act, as amended in 1968 (authorizing the Secretary to insure mortgages on property "located in an older, declining urban area...") can be regarded as a Congressional intent that assisted housing programs were not to be withheld from the central city. Section 3 of the 1968 Act further bears this out by requiring that, in administering the subsidized housing programs, there be opportunities for employment and training of lower

income persons residing in the area. Aside from these sections, there is no clear intent as to the location of subsidized housing in the 1968 Act.

A separate enactment, the Civil Rights Act of 1968, required the Secretary to affirmatively administer the Department's programs so as to further the policy of fair housing. However, the Act did not specifically provide the Secretary with guidance as to the location of subsidized housing. Although HUD had developed a site selection policy for low-rent public housing, no such policy had been developed for the other subsidized housing programs. The Shannon decision on December 30, 1970,¹⁸ officially ordered the Department to develop an institutionalized method for reviewing site locations for all low- and moderate-income subsidized housing that would take racial concentrations in local communities into account prior to approval. The court opinion criticized HUD's lack of an official policy for the location of subsidized housing projects and concluded that the lack of a policy on this matter had caused greater racial concentrations, thereby violating, in the court's view, the Civil Rights Acts of 1964 and 1968:

"The essential substantive complaint is that the location of this type of project on the site chosen will have the effect of increasing the already high concentration of low-income black residents in the East Poplar Urban Renewal Area. The essential procedural complaint preserved on appeal is that in reviewing and approving this type of project for the site chosen, HUD had no procedures for consideration of and in fact did not consider its effect on racial concentration in that neighborhood or in the City of Philadelphia as a whole."

In the most recent decision (September 11, 1973) in the continuing consolidated litigation of Gautreaux v. Romney and Gautreaux v. Chicago Housing Authority, the court has ordered HUD to lend its best efforts to assisting the Chicago Housing Authority to carry out the court's order requiring placement of public housing in white neighborhoods within the city limits. This order implemented the earlier opinion of the Seventh Circuit Court of Appeals

¹⁸Shannon V. United States Department of Housing and Urban Development, 436 Fed.2d 809 (1970).

that HUD had violated the Fifth Amendment and Title VI of the Civil Rights Act of 1964 in approving the location of public housing principally in black neighborhoods.

In June, 1971 -- after the Shannon decision but before the Gautreaux decision -- HUD published draft Project Selection Criteria which stated the Department's policy toward racial and economic concentration of subsidized housing projects. Criterion 2, Minority Housing Opportunities, exemplified how the Department responded to the Shannon decision. The objectives of this criterion are:

1. To provide minority families with opportunities for housing in a wide range of locations.
2. To open up non-segregated housing opportunities that will contribute to decreasing the effects of past housing discrimination.

The objective of dispersing minorities out of the central city tends to make more difficult the legislatively formulated production goal of six million subsidized units.

Achievement of both such goals together, to some extent probably speeds deterioration of housing in the central cities, rather than preventing it, and this runs counter to another explicit goal of the 1968 Act. Dispersing residents out of central cities reduces demand in such cities for housing and discourages maintenance by landlords, which eventually may lead to abandonment. A policy to achieve racial dispersion may also tend to increase the cost of subsidized housing through project delay and additional costs of administering the guidelines.

Two studies undertaken by HUD provide some insight into how the subsidized housing programs have affected racial dispersion, but neither specifically evaluates the Project Selection Criteria policy because of the time frame and nature of the study samples. Only two years have passed since the Project Selection Criteria were implemented -- many subsidized housing projects were in the "pipeline" and thus not affected before the policy was announced -- and many projects that have obtained approval under the Criteria have still not been completed.

One 1972 HUD study of the Section 236 rental assistance program in the Washington, D.C. metropolitan area showed that in the central city the proportion of blacks in Section 236 projects was always higher than the already high propor-

tion in the census tract. (See Table 11) This would indicate that the Section 236 program, at least in the Washington metropolitan area, was unable to affect racial concentration trends prevalent in the central city. On the other hand, Section 236 projects in suburban areas did appear to contribute to racial balance across neighborhoods. In almost every instance, the proportion of blacks in the Section 236 projects in suburban areas was considerably higher than in the surrounding neighborhood.

The study also reviewed the locations of the former homes of a number of the black residents to determine whether the higher proportion of blacks in the suburban Section 236 projects resulted from (1) drawing blacks from other suburban locations, or (2) drawing blacks from central city locations. The latter case would indicate that the Section 236 projects in suburban Washington were contributing to racial dispersion. About 21 percent of the minority residents in the suburban projects had formerly resided in the Washington central city -- practically all the others came from within the same county (52 percent) or from another suburban county (23 percent). If blacks located in the central city moved into the former suburban residences of those blacks who occupied the units in the Section 236 projects, further dispersive effects may have resulted. However, the study did not follow the "chain-of-moves" of the residents to determine whether this was true.

The National Housing Policy Review analyzed how the Sections 235 and 236 programs effected social dispersion in the Far Western, Southwestern and Middle Atlantic regions of the country (HUD Regions III, VI, and IX). The study showed that the programs had provided suburban housing opportunities to minorities. Of significance is the fact that 18 percent of blacks moving within Standard Metropolitan Statistical Areas into subsidized housing within each of the three regions moved from the central city to suburban areas. This compares with a national rate for such moves of only about 7 percent for blacks between 1965 and 1970. The rate for all races moving into suburban subsidized housing from the central city was also higher in the programs analyzed by the study than the national rate between 1965 and 1970 -- 20 compared to 15 percent. Thus, subsidized housing appeared to be providing suburban housing opportunities to some central city low- and moderate-income families, particularly blacks.

One additional question is whether minority households are served by the housing subsidy programs as frequently as other low-income households. In fact, the evidence indicates

TABLE 11

1970 BLACK POPULATION AS PERCENT OF PROJECT, BLOCK AND TRACT, WASHINGTON METROPOLITAN AREA

PROJECT AND LOCATION	236 PROJECT	CENSUS BLOCK	CENSUS TRACT
WASHINGTON, D.C. (CENTRAL CITY)			
PROJECT A	100%	100%	92%
B	100	98	89
C	100	93	67
D	100	98	94
E	100	99	69
MARYLAND SUBURBS			
PROJECT F	82	3	1
G	31	20	4
H	96	26	25
I	22	NA	7
J	45	2	2
K	60	13	17
L	17	3	8
M	0	2	1
N	15	NA	2
VIRGINIA SUBURBS			
PROJECT O	45	NA	2

NA = NOT AVAILABLE.

NOTE: THE BUREAU OF THE CENSUS PUBLISHES DATA BY CENSUS TRACT AND BLOCK. THE AVERAGE TRACT HAS ABOUT 4,000 RESIDENTS; CENSUS BLOCKS ARE USUALLY CITY BLOCKS.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION AND HOUSING.

that they are served more. Table 12 shows the percentage of the households served at several income levels, for the whole United States and for two minority groups. Both minorities, but especially blacks as compared to Spanish Americans, have higher shares of subsidized units compared to other low-income families in the same income level. At each low-income level, about three times as high a proportion of blacks live in subsidized housing as do all households.

These studies indicate that the subsidized housing programs tend to increase partially the opportunity for the dispersion of central city inhabitants, particularly minorities, to suburban areas. There is also some evidence that the programs contribute to racial mixing. However, the significance of the contribution of subsidized housing to racial dispersion is small in comparison to the amount of racial imbalance that exists.

THE SECTION 235 PROGRAM¹⁹

The Section 235 homeownership assistance program established in the 1968 legislation is the largest subsidy program through which the Department of Housing and Urban Development specifically attempts to provide homeownership. The HUD Section 235 Handbook, issued in January 1973, states the objectives of the program succinctly:

"The program is intended not only to produce more homes, but to enable lower income families to become owners of homes and thereby experience the pride of possession that accompanies homeownership. In this way, the program can be a vital influence in promoting personal responsibility and social stability."

The Section 235 program is basically production-oriented both in terms of the stated goals of the program, and in its structural and administrative make-up. The program was designed to help achieve the target of six million new or substantially rehabilitated units for low- and moderate-income families by 1978, and the subsidy is tied to the house, not the homeowner.

¹⁹In the analyses of each of the subsidized programs, extensive use is made of the concepts developed in the section, "Criteria for a Nationwide Evaluation." Precise definitions of the technical terms used can be found on pages 4-6 through 4-15.

TABLE 12

PERCENT OF HOUSEHOLDS SERVED BY HUD SUBSIDY PROGRAMS, BY INCOME AND MINORITY GROUP,
AS OF DECEMBER 31, 1972

GROSS INCOME	TOTAL U.S.	BLACK	SPANISH AMERICAN
\$ 0 - 999	1%	2%	LESS THAN .5%
1,000 - 1,999	7	19	9
2,000 - 2,999	7	20	10
3,000 - 3,999	6	18	11
4,000 - 4,999	6	17	11
5,000 - 5,999	5	14	10
6,000 - 6,999	4	11	9
7,000 - 7,999	3	7	6
8,000 - 9,999	1	4	3

NOTE: EXCLUDES PROGRAMS ADMINISTERED BY THE FARMERS HOME ADMINISTRATION.

1 SUBSIDIZED HOUSEHOLDS ARE AS OF DECEMBER 31, 1972.

TOTAL HOUSEHOLDS ARE AS OF THE 1970 CENSUS.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION.

The subsidy formula is calculated as the lesser of either (1) the difference between (a) 20 percent of monthly adjusted income and (b) the total monthly payment under the mortgage for principal, interest, mortgage insurance premium, taxes, and hazard insurance, or (2) the difference between (a) the monthly payment for principal, interest and the mortgage insurance premium, and (b) the payment to principal and interest at a one percent interest rate.

Viewed one way, the subsidy places a special burden on some Section 235 families. Those receiving the maximum subsidy under the second formula, usually the lower income Section 235 families, must bear increases in taxes and insurance without increased assistance. The higher income families, who usually are subsidized under the first formula, have their subsidy raised to cover the entire increase in taxes or insurance until the second formula subsidy limit is reached.

A builder/sponsor under Section 235 usually has strong demand for his product provided he builds according to HUD regulations. A family must be lucky enough to be the one out of 50 income-eligible Section 235 families (on average) selected for homeownership by the builder/sponsor and the mortgagee.

In addition, for many of the Section 235 families whose shares of mortgage payments are based on 20 percent of adjusted gross incomes, there is no incentive to be concerned about whether a higher price represents more "house" since they do not pay the additional price themselves. Thus, the builder faced with strong demand may be able to "capture" some of the Government subsidy by encouraging the family to purchase an expensive house with the higher cost being covered by a higher Government subsidy.

This counter-productive incentive structure highlights the crucial role that HUD appraisers and inspectors must play in order to hold down excess profits and protect the interests of the Government. However, abuses and fraud are an inherent danger of such an incentive structure and have occurred in some cases.

For the Section 235 homeowner family, the subsidy is typically large (equal to about one-eighth of the family average income). There is little financial risk to the homeowner because his initial equity is frequently less than the deposit on an apartment, while the Government bears

practically all of the risk of a Section 235 home by providing insurance for the mortgagee. In the past HUD has not sought deficiency judgments to recover costs against Section 235 homeowners whose homes have been foreclosed.

The income and mortgage limits predetermine most of the characteristics of the participants and the units produced. The mortgage limits range from \$18,000 to \$24,000, depending on family size and location, and the income limits are set at 135 percent of local housing authority income limits. However, there is a significant exception to this general rule. Twenty percent of the contract authority may assist households with incomes up to 90 percent of the Section 221(d)(3) below market interest rate income limits. Using the income limits from this program has the effect of allowing higher income families to enter the Section 235 program.

In contrast to such legislatively determined upper limits, the lower mortgage and income limits are set administratively by HUD's Minimum Property Standards for the unit and by mortgage credit standards for the applicant. Given local building costs, the setting of Minimum Property Standards has the effect of establishing minimum cost and therefore the minimum mortgage amount. The higher the standards the more expensive the home. The mortgage amount and the stringency of the mortgage credit standards determine the effective lower income limits. A general rule is that the mortgagor's share of the total mortgage payment should not under ordinary circumstances exceed 35 percent of net effective family income. Some major characteristics of the Section 235 program are presented in Table 13.

MAJOR FINDINGS

1. The Section 235 homeownership program has not made significant progress toward achieving equity. Only 12.6 percent of the families served have incomes of less than \$5,000 annually. Yet families with annual incomes of less than \$5,000 more often live in sub-standard and low quality housing than families earning more than \$5,000 annually. In the income class with greatest participation (\$6,000-\$6,999), only 2.7 percent of eligible families are served. A household is five times more likely to be served if it resides in the South than in the Northeast or Middle Atlantic regions.

TABLE 13

CHARACTERISTICS OF THE SECTION 235 PROGRAM, 1972

UNITS ASSISTED THROUGH DECEMBER 31, 1972 (HOME INSURANCE WRITTEN)	398,000
TOTAL MORTGAGE AMOUNTS THROUGH DECEMBER 31, 1972 (HOME INSURANCE WRITTEN)	\$7.0 BILLION
MAXIMUM ANNUAL SUBSIDIES PERMITTED BY LAW THROUGH FISCAL YEAR 1973 (CONTRACT AUTHORITY RELEASED IN APPROPRIATIONS)	\$665 MILLION
MEDIAN MORTGAGE AMOUNT PER UNIT	\$18,500
MEDIAN BUYER INCOME	\$6,500
RACIAL AND ETHNIC COMPOSITION OF BUYERS:	
NON-MINORITY WHITE	66%
BLACK	22%
SPANISH AMERICAN	11%
OTHER	2%

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

2. Subsidies received by recipients actually increase as gross family income increases.
3. The program provides substantial benefits to the recipients. Housing quality of recipients improved by 35 percent and non-housing expenditures increased by 8 percent.
4. Total Government costs are about 15 percent greater than the cost of the subsidy. Forgone taxes and administrative costs account for most of the difference.
5. A dollar spent by Government on the Section 235 program results in only 79 cents worth of benefits from the viewpoint of the recipient.
6. Counter-productive program incentives may reduce the efficiency and equity of the program. These structural "incentives" aimed at builders and developers rather than the intended beneficiaries may lead to more expensive homes and higher default and foreclosure rates.
7. This study did not demonstrate that Section 235 housing costs more than comparable privately produced units.
8. The insurance fund for Section 235 appeared to be actuarially sound through 1972, but recent trends in foreclosures and assignments throw this conclusion into doubt.
9. The main problems appear to be structural problems inherent in the production subsidy in-kind approach. Some administrative changes could reduce the counter-productive incentives.

EQUITY: Table 14 shows the distribution of Section 235 participants by gross income class, as well as other information on the equity aspects of the program. The table makes apparent the serious horizontal inequity in the program. Very few of the income eligible families in each income class receive Section 235 benefits. In addition, the average subsidy actually increases in the upper income range. This results because higher income families tend to be larger and thus have lower adjusted incomes than smaller families with the same gross income and because higher income families tend to purchase more expensive homes both because of their larger families and their greater expectations. The decrease in the Government subsidy that would be expected due to their higher income is more than offset by the more expensive homes that higher income families purchase.

TABLE 14

**DISTRIBUTION OF SECTION 235 HOUSING, BY INCOME CLASS,
AS OF DECEMBER 31, 1972**

(1)	(2)	(3)	(4)	(5)
GROSS INCOME	PERCENT DISTRIBUTION OF HOUSEHOLDS SERVED BY 235	235 HOUSEHOLDS AS PERCENT OF ALL HOUSEHOLDS	DIRECT ANNUAL SUBSIDY PER HOUSEHOLD SERVED	DIRECT ANNUAL SUBSIDY PER HOUSEHOLD IN THE (A) INCOME CLASS
\$0- 999	(B)	(B)	--	--
1,000-1,999	(B)	(B)	--	--
2,000-2,999	.3%	(B)	\$720	\$.19
3,000-3,999	2.1	.2%	768	1.52
4,000-4,999	10.2	1.0	780	7.70
5,000-5,999	23.7	2.3	768	18.03
6,000-6,999	26.4	2.7	768	20.83
7,000-7,999	19.3	1.9	792	14.80
8,000-9,999	15.9	.8	828	6.71
10,000 OR MORE	2.1	(B)	864	.21

(A) TOTAL SUBSIDY PAID TO AN INCOME CLASS SPREAD AMONG ALL HOUSEHOLDS IN THAT INCOME CLASS.

(B) LESS THAN .05%.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NOS. 84 AND 87, AND 1970 CENSUS OF POPULATION.

The vertical inequity in the program is best illustrated by column 5 in Table 14 where the total subsidy paid to an income class is spread among all eligible families in the respective class. Families in the \$6,000 to \$7,000 annual income class benefit most from the program; put another way, the least needy and the class presumably already living, as a general matter, in better housing within the target group of \$3,000 to \$7,000 income²⁰ receive the most subsidy.

Table 15 presents a measure of geographic equity and inequity in the program. The table reveals that about 49 percent of the Section 235 units are concentrated in Regions IV and VI, which have only about 25 percent of the Nation's population, and 30 percent of the Nation's population in the \$3,000 to \$7,000 annual income range. Moreover, Regions I, II, and III have about 9 percent of the units but nearly 31 percent of the total population and 29 percent of the "eligible" population. The concentration of units in the South, Regions IV and VI, can be explained in part by the statutory mortgage limits and the relatively lower cost of construction in these areas. These factors make new construction more feasible in the South.

Taken together, the tables show that the homeownership assistance program has not made significant progress toward achieving equity.

IMPACT: One legislative goal of the Section 235 program is to produce more "standard" housing. A measure of the success of the program could presumably be demonstrated by adding up the number of standard housing units constructed.

However, in measuring the impact of the Section 235 program, totaling the number of new units would be an overstatement because it is likely that to some extent developers participating in the subsidy program would have produced other housing in the absence of the program. A recent study concluded that for every 100 subsidized units undertaken, 86 unsubsidized starts previously planned were canceled, primarily because subsidized starts reduce the limited amount of mortgage market funds available for unsubsidized starts.²¹

²⁰U.S. Congress, Report of the House Committee on Banking and Currency on H.R. 17989, House Report No. 1585, Washington, D.C.: Government Printing Office, 1968.

²¹Craig Swan, "Housing Subsidies and Housing Starts," Washington, D.C.: Federal Home Loan Bank Board, Working Paper No. 43, April 1973. This point is discussed later, in the section entitled "Impact on the Housing Stock."

TABLE 15

SECTION 235 REGIONAL DISTRIBUTION, AS OF DECEMBER 31, 1972

(1)	(2)	(3)	(4)	(5)
HUD REGION	PERCENT OF 235 UNITS PRODUCED	PERCENT OF U.S. HOUSEHOLDS	PERCENT OF U.S. HOUSE- HOLDS HAVING BETWEEN \$3,000 AND \$7,000 ANNUAL INCOME	UNITS TO TARGET GROUP (COL.2 + COL.4)
I	1.9%	5.7%	5.1%	.4
II	3.8	13.7	12.4	.3
III	3.0	11.3	11.3	.3
IV	29.2	15.2	18.7	1.6
V	17.6	21.1	18.0	1.0
VI	19.4	9.7	11.4	1.7
VII	4.8	5.6	6.2	.8
VIII	4.3	2.6	3.0	1.5
IX	10.4	11.7	10.8	1.0
X	5.3	3.3	3.1	1.7
TOTAL U.S.	100.0%	100.0%	100.0%	1.0

NOTE: SEE TABLE 10 FOR STATE COMPOSITION OF THE REGIONS. DETAIL
MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY
REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN
DEVELOPMENT AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970
CENSUS OF POPULATION.

Conceivably, the objective of providing standard housing for the target group specified in the Section 235 program could have been attained without increasing the number of new units if there had been an improvement in the quality of the existing low quality stock. Although any changes in the housing quality of non-program beneficiaries cannot be measured precisely, the improvement in the quality of housing occupied by recipients can be calculated.

The "extra housing" that a Section 235 family receives is measured by the difference between what the unit would cost in the private market and what the owner actually pays toward the mortgage. It is possible that the sum of the Government subsidy and the owner's contribution could be greater than the private market's evaluation of the unit. This would be true if the construction costs of Section 235 housing were more expensive than what they would have been in the private market. However, a June 1973 study of nine housing markets containing almost 2,000 Section 235 housing units located in three HUD regions indicated that the construction costs for Section 235 units were very similar to those of conventional units.²²

The presumption that Section 235 houses and comparable private houses sell for the same price means that the owner receives the full value of the subsidy, in the form of "extra" housing. This amount equals about \$948 per year for a sample of 329 Section 235 homeowners in ten Standard Metropolitan Statistical Areas.

But of more importance in assessing the impact of the program is the percentage improvement in housing quality induced by the program. This figure is estimated by comparing the housing budgets of families participating with those having the same income but not participating in the program. Housing improvement is estimated to be about 35 percent for participants in the Section 235 program.

Not all of the subsidy is taken in the form of better housing. To the extent that a family has flexibility in its spending habits despite the fact that it must purchase a given amount of housing to participate in the program, it will allocate the funds previously spent on housing for non-housing commodities. The subsidy is not a simple add-on to their previous housing budget. A figure of 8 percent

²² Department of Housing and Urban Development Regions III, VI and IX, Tri-Regional Study conducted for the National Housing Policy Review, Department of Housing and Urban Development, June 1973.

has been estimated as the increase in non-housing expenditures for Section 235 families compared to the control group.

Since a Section 235 homeowner family is constrained to purchase a certain type and quality of housing with its subsidy dollars, these funds are valued less by the family than unrestricted dollars. The measure of the value of the subsidy to the recipient is called the benefit to the recipient. For the Section 235 program, the \$948 annual subsidy is valued by the average family at \$857, or \$71 per month.

COSTS: There are five types of costs that the Federal Government must bear in order to provide the services of the Section 235 program. The costs were estimated over the life of the program, using assumptions of income and cost growth rates based on past experience of 5.7 and 6 percent, respectively. Where there were start-up costs, the costs were amortized over the projected 11 year life of the program using a 6 percent discount rate.

By far the most important cost to the Federal Government is the direct subsidy cost paid by HUD to the mortgagee. For 1972, the estimated average direct subsidy was \$948. A second important cost to the Federal Government is the taxes that are not paid (forgone) because of the program. Homeowners may deduct mortgage interest payments and property taxes from their taxable income. However, this cost was not counted because all homeowners are entitled to this deduction. But Section 235 homeowners -- unlike other homeowners -- are also entitled to deduct the interest and property taxes that the Government pays by means of the subsidy. The cost to the Government of this entitlement was calculated to be \$61 for the average family occupying Section 235 housing in 1972.

The administrative cost of the program was divided into endorsement, maintenance, and settlement costs and spread over the "expected" life of the units subsidized. For 1972 these costs amounted to \$70 per unit. However, this is an overestimate since the mortgage insurance premium, part of which is paid by the Government to itself, is used to offset administrative expenses connected with the program as well as the specific mortgage losses borne by HUD because of default terminations. This offset was estimated at \$15 per unit for 1972 and was subtracted from the total administrative costs.

On an assumption -- albeit now questionable -- that the special risk insurance fund for Section 235 was actuarially sound in 1972, no additional adjustments were made to account for foreclosure losses. Specifically the predicted final default termination rate and average loss per mortgage plus administrative costs was assumed to be equaled to the income generated by the one-half percent mortgage insurance premium.

Finally, the Government National Mortgage Association (GNMA) from time to time provides an additional subsidy to support Section 235 mortgages when the FHA interest ceiling is below the market interest rate. GNMA issues commitments under the Tandem Plan to buy mortgages at 97 percent of par, and in turn sometimes sells them for a lower price. Actual Section 235 Tandem Plan losses for Fiscal Years 1972 and 1973 and projected losses for Fiscal Year 1974 were amortized at 6 percent over the "expected" life of the program and allocated evenly over each year. The estimated cost for 1972 was about \$24 per mortgage.

The estimated total 1972 cost of the program to the Federal Government therefore was \$1,087 per unit, or approximately \$400 million for the total program.

EFFICIENCY: The efficiency measures relate benefits and costs to come up with an overall evaluation of the program relative to the private market. An important part of the efficiency aspect of the program is whether counter-productive incentives, departmental red tape, quality standards, and delays increase the cost of subsidized housing relative to comparable housing in the private market. Theoretically, this might be expected to be the case if the private market were competitive. However, several factors mitigate this conclusion. First, a Section 235 house is not actually designated as such until an eligible buyer is certified. Thus the builder is not always assured of subsidy benefits and is more likely to build competitively. Second, HUD's appraisals and cost analyses tend to keep the selling price of Section 235 units in the range of the approximate "market value."

The empirical evidence gathered for almost 2,000 units in nine cities did not show that the average Section 235 house costs more than similar privately constructed housing. This does not necessarily imply that Section 235 construction is as efficient as conventional construction. Alternate explanations are that Section 235 units are located on less desirable and thus lower cost land or that Section 235 builders accept a lower profit margin because of the lower risk involved in selling subsidized housing.

One significant drawback of this cost study is that there appears to be almost no non-FHA housing in urban areas constructed within the Section 235 mortgage limits other than mobile homes. Although the cost study attempted to adjust for differences in amenities, it is doubtful that all housing quality as well as neighborhood differences were taken into account in the adjustments. Nevertheless, the net effect on construction costs of the findings is to produce a Construction Efficiency Index of 1.0; consequently the market value of the subsidy is equal to the dollar value of the subsidy.

Production Efficiency is a measure which depends on the relative costs of identical subsidized versus unsubsidized housing construction plus the indirect costs of the program. For this program, the indirect costs such as taxes forgone, administrative costs, and the Government National Mortgage Association Tandem Plan produce an efficiency of less than one.

$$\text{Production Efficiency} = \frac{\$ 948}{\$1087} = .87$$

A family is constrained in its use of a subsidy when it is provided in-kind -- that is, in actual housing rather than in dollars paid directly to the recipient. It is generally agreed that because of the inherent restriction of choice, an in-kind transfer usually is not worth as much to an individual as an outright cash grant. Transfer Efficiency is a measure which takes this factor into account. The estimate is based on a sample of 329 Section 235 families in ten cities and on an approach which measures the "utility" of the subsidy to the average family. Transfer Efficiency is defined as the ratio of the cash value of the subsidy in-kind relative to the market value of the subsidy. In the Section 235 program the market value of the subsidy is assumed to be equal to the dollar amount of the subsidy since the aforementioned study did not indicate a difference between the construction cost of Section 235 housing and identical conventionally-financed housing.

$$\text{Transfer Efficiency} = \frac{\$857}{\$948} = .90$$

The overall measure of the efficiency of the program is a combination of Production Efficiency and Transfer Efficiency called Program Efficiency. Program Efficiency is the ratio of the cash value of the subsidy to the recipient to the total Federal costs.

$$\text{Program Efficiency} = \frac{\$ 857}{\$1087} = .79$$

This measure represents the net benefits to the private individual relative to the total cost incurred by the Government in providing that benefit. The continuation of the program may be questioned if benefits in the vicinity of \$230 per year (the difference between the cash value to the recipient and the total Federal cost) are not provided to the rest of society by the provision of a Section 235 home. However, because social benefits are almost impossible to measure this estimate can be used by policy makers as a benchmark to determine the amount of social benefits required in order for the program to be Socially Efficient. Overall, the Section 235 program would have had to produce about \$85 million in social benefits in 1972 to be deemed Socially Efficient.

PROGRAM VIABILITY: The latest simulations conducted for the program, based on four years of experience as well as the last 26 years of the Section 203(b) basic mortgage insurance program, indicated that the insurance fund for Section 235 was actuarially sound but at the break-even point. A final default termination rate of 18.6 percent has been calculated and an average life expectancy of 16.1 years generated.

Other data indicate that the average loss to HUD from a default termination is now \$4,350 per unit, a figure at the maximum of the 25 percent loss rate sustainable by the mortgage insurance premium given a final default termination rate of 18.6 percent. Therefore, as long as foreclosures and acquisition losses do not increase beyond present estimates, the Section 235 program can be regarded as actuarially sound. However, the most recent data on foreclosures and acquisition costs have indicated that the fund may become actuarially unsound.

THE SECTION 236 PROGRAM

The Section 236 rental and cooperative housing program authorized by the 1968 Act involves the Government in three activities: stimulating housing production; subsidizing housing for rental by low- and moderate-income families; and insuring multifamily mortgages. The first and third activities are designed to promote the second, which is the ultimate goal of the program.

All Section 236 projects are privately-owned and financed. FHA mortgage insurance encourages the participation of private lenders by greatly reducing the risks. When the FHA interest ceiling is below the market interest rate, an additional subsidy (GNMA Tandem Plan) is often necessary to obtain private financing. Any non-profit organization, tenant cooperative group, corporation, partnership, or individual may become the sponsor (owner) of a project. An individual or profit-making corporation or partnership must limit the cash return to 6 percent of invested equity. For this reason, profit-making entities are called limited dividend sponsors. In addition to their allowed rate of return, investors in limited dividend projects also benefit from special tax advantages and other opportunities for profit during the development of a project. In exchange for its direct regulation of rents and a general determination of tenant eligibility, the Federal Government agrees to subsidize a Section 236 project by paying the difference in monthly installments between (i) amortization of the mortgage at the FHA ceiling interest rate plus FHA insurance premium and (ii) amortization at 1 percent.

To be eligible for a Section 236 subsidy, a family's income must be no more than 135 percent of the income limit for low-rent public housing in that particular area at the time of initial occupancy. Income is adjusted for family size and limited exceptions to this income rule are permitted. Two rents are associated with each program unit. The "market rent" is equal to the sum of operating expenses, amortization of that portion of the mortgage associated with the unit at the FHA ceiling interest rate, and the mortgage insurance payment. The "basic rent" is equal to operating expenses plus amortization at 1 percent interest. The tenant must pay the "basic rent" or 25 percent of his adjusted monthly income, whichever is greater. In no case is he required to pay more than the "market rent." The sponsor must turn over to HUD all rent receipts in excess of "basic rent."

A limited percentage of Section 236 families can receive an additional rent supplement subsidy. This "piggy-backing" of subsidy benefits substantially increases the depth of the subsidy with minimum tenant rent falling to 30 percent of the basic rent.

Table 16 provides some general information on the program: its magnitude, project types, and tenant characteristics.

TABLE 16

CHARACTERISTICS OF THE SECTION 236 PROGRAM, 1972 (INCLUDING PROJECTS WITH UNITS UNDER RENT SUPPLEMENT)

UNITS ASSISTED THROUGH DECEMBER 31, 1972* (FINALLY ENDORSED)	142,000
TOTAL MORTGAGE AMOUNTS THROUGH DECEMBER 31, 1972* (FINALLY ENDORSED)	\$2.2 BILLION
MAXIMUM ANNUAL SUBSIDIES PERMITTED BY LAW THROUGH FISCAL YEAR 1973*(CONTRACT AUTHORITY RELEASED IN APPROPRIATIONS)	\$700 MILLION
UNITS IN PROCESS AND UNITS FINISHED PROCESSING AT THE END OF FISCAL YEAR 1973* (RESERVATIONS AND OBLIGATIONS OF CONTRACT AUTHORITY)	451,000
UNITS COMPLETED, BY SPONSOR TYPE:	
LIMITED DIVIDEND	62%
NON-PROFIT	31%
COOPERATIVE	7%
MEDIAN MORTGAGE AMOUNT PER UNIT	\$16,700
MEDIAN INCOME OF NEW TENANTS	\$5,300
RACIAL AND ETHNIC COMPOSITION OF NEW TENANTS:	
NON-MINORITY WHITE	76%
BLACK	20%
SPANISH AMERICAN	3%
OTHER	1%

* EXCLUDES UNITS FINANCED THROUGH STATE AND LOCAL PROGRAMS AND NOT INSURED BY FHA
(SEE CHAPTER 5).

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

MAJOR FINDINGS

1. The Section 236 program provides sizable Federal housing subsidies, mainly to moderate-income households.
2. The Section 236 program serves less than 1 percent of all households earning less than \$8,000 per year.
3. Tenants occupy units which are about 50 percent better than the housing they would have occupied in the absence of the program. Expenditures on non-housing goods are little changed, however.
4. The "market rent" of a Section 236 unit is higher, on average, than the rent charged for an identical unit in the private market.
5. On average, Section 236 units cost about 20 percent more to construct than comparable privately financed units.
6. Federal costs exceed the market value of the housing provided to the tenant by approximately 40 percent in the regular program and approximately 20 percent in the Section 236 rent supplement piggy-back program.
7. The main reason Federal costs exceed market value is that Section 236 units are not rent competitive with identical private units and therefore the direct subsidy is spent inefficiently. The additional cost of forgone tax revenue, administrative overhead, and foreclosure losses also contribute to the excess of costs over housing value.
8. A Section 236 subsidy is worth only 65 to 70 percent as much to a tenant as its market value because the subsidized unit provided is better housing than he would choose if given a cash grant equal to the subsidy.
9. Tenant welfare is increased by only about 50 cents for every dollar spent because Federal costs are higher than the value of the housing provided and because the tenant places a lower value on the transfer in-kind benefit than on an unrestricted cash grant.
10. Approximately 20 percent of all Section 236 units are expected to fail in the first ten years of operation. The program does not appear to be actuarially sound.

EQUITY: Table 17 shows the distribution of Section 236 tenants on the basis of unadjusted family income. The percentages are based on recent tenant admissions, but earlier admissions show a similar pattern. Unadjusted income was used to allow for comparisons with Census data.

Almost three quarters of all Section 236 tenant families have annual incomes in the \$4,000 to \$8,000 range. This distribution is the result of the program's predominant reliance on newly constructed units and the limited size of the subsidy.²³ Another factor has also diminished the extent to which the program has been able to serve those earning below \$4,000. Sponsors have an incentive to serve families which have steady income and are able to easily afford the rent. They may also avoid "problem" tenants. This policy reduces management problems, insures a steady flow of rent receipts, and allows flexibility in raising rents when operating costs increase.²⁴ Limited dividend sponsors may be more responsive to these incentives. A random sample of projects revealed that the average income of tenants in limited dividend projects is 28 percent higher than the average income of tenants in non-profit projects.

The probability of receiving a Section 236 subsidy increases with income through the \$5,000 to \$6,000 annual income range and declines after that (Table 17, column 4). However, the differences between these percentages are small and may be simply the result of normal variation.

Column 5 of Table 17 sets forth the number of Census households in each income group who, although eligible to participate in the programs, are not residents of federally subsidized housing and who earn less than the lower limit of that income group. Although 57 percent of all Section 236 program units are occupied by families with gross annual

²³HUD program data indicates that the great majority of all Section 236 tenants pay only the basic rent. Reliable information as to whether the combination of Section 236 and rent supplement benefits has enabled lower income families to afford Section 236 units is unavailable.

²⁴When confronted with a potentially serious mortgage default problem HUD acquiesced in such selectivity and tried to limit participation in the program to families who could afford the basic rent with less than 35 percent of their monthly income. This regulation was put aside by a court ruling.

TABLE 17

**DISTRIBUTION OF SECTION 236 (INCLUDING 236 RENT SUPPLEMENT) HOUSING,
BY INCOME CLASS, AS OF DECEMBER 31, 1972**

(1) GROSS INCOME	(2) HOUSEHOLDS SERVED BY 236		(3)	(4)	(5)	(6)
	NUMBER	PERCENT DISTRIBUTION		236 HOUSEHOLDS AS PERCENT OF ALL HOUSEHOLDS	RESIDUAL NEED *	DIRECT ANNUAL SUBSIDY PER HOUSEHOLD SERVED
\$0- 999	220	.2%		.01 %	--	\$956
1,000-1,999	3,200	2.3		.08	1,800,000	974
2,000-2,999	11,590	8.2		.27	5,300,000	1,081
3,000-3,999	16,980	12.0		.43	9,300,000	1,021
4,000-4,999	28,370	20.1		.74	13,100,000	980
5,000-5,999	33,710	23.9		.90	16,700,000	1,011
6,000-6,999	26,290	18.6		.73	20,300,000	1,093
7,000-7,999	13,590	9.6		.35	23,700,000	1,233
8,000-9,999	6,410	4.5		.09	27,400,000	1,455
10,000 OR MORE	640	.5		LESS THAN .005%	34,600,000	1,189

* NUMBER OF HOUSEHOLDS LIVING IN UNSUBSIDIZED HOUSING EARNING LESS THAN LOWER LIMIT FOR THAT INCOME CLASS, AS GIVEN IN COLUMN 1.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NOS. 84 AND 87, AND 1970 CENSUS OF POPULATION.

incomes in excess of \$5,000, there are 16.7 million households with lower incomes who do not receive any housing subsidy, whatsoever. There are also 13.1 million households earning less than \$4,000 who are not living in subsidized housing. In considering these figures, two facts must be noted. Not all households would accept subsidized housing if it were offered to them. Secondly, many of the Section 236 households with incomes above \$4,000 or \$5,000 may be more needy than some of the unserved households with lower incomes because of larger household size, limited future income prospects, fewer assets, or other reasons. Unfortunately, the data cannot be adjusted to account for these factors. However, for the same reason, some of the unserved households may be even more needy than their income suggests.

The overwhelming majority of all Section 236 tenants earn less than the national median household income (\$9,698 March 1973). The direct benefits accrue chiefly to the \$4,000 plus group. Other subsidized housing programs -- rent supplement and low-rent public housing -- serve lower income groups. Deeper subsidies and simpler units explain the difference in population served.

Column 6 of Table 17 indicates that the average Section 236 program benefit increases slightly and irregularly with income. This result is surprising because the rent formula indicates that tenant rent increases with income. Most Section 236 program families received the maximum benefits for which they are eligible, i.e., the full difference between market rent and basic rent. The size of this maximum benefit depends upon land and construction costs per unit. Total development costs also determine the income groups which can afford to live in the projects since all tenants, except those with rent supplements, must legally pay at least the basic rent. As a result, projects with high total development costs have higher maximum benefits and serve higher income people; projects with lower total development costs can serve lower income persons but also have lower maximum benefits. Given this explanation, local differences in development costs could produce the effects noted in Column 6.

Column 4 shows the percentage of households served in each income group. The Section 236 program provides housing for less than one percent of families in each income group, even in the \$5,000 to \$8,000 range. The ability to serve a large percentage of the needy depends on the average cost per family and on the total level of program funding. Benefits per household under Section 236 are substantial, the average annual subsidy being \$956 for a regular unit and

\$1,975 for a rent supplement piggy-back unit. The units are generally more expensive than the average unsubsidized unit. Table 18 compares average Section 236 market rents in five cities with the mean private rent in 1970 and with the Bureau of Labor Statistics estimates of renter costs in its lower budget for a family of four. The national data show a similar pattern. If simpler units could be provided at less subsidy cost per family, then more families could be served from the same budget. Even taking into account that the market rent frequently overstates the quality of the unit (see below), Section 236 units are of higher quality than the average private unit.

IMPACT: The strategy of the Section 236 program is to relieve housing problems of lower income families by offering them units which provide more housing services than they could purchase with the same rent in the private rental market.²⁵

How much "extra housing" does the average tenant family receive? This quantity is measured by the difference between what the Section 236 unit would rent for in the open market and the rent paid by the tenant.

The average subsidy is \$956 per year. The average subsidy when the piggy-back mechanism of rent supplements is applied is \$1,975. These figures in effect, for the reasons noted above, measure the average difference between market rents (the cost of constructing and operating a unit) and tenant rents. It may cost more, however, to provide a subsidized unit than a conventional unit. Therefore, the stated market rent of a unit may be more than the actual rent that could be demanded for that unit on the open market. In that case, the average subsidy overstates the "extra housing" received by the tenant. In fact, the analysis for the Section 236 program establishes that the average tenant in a non-rent supplement Section 236 unit receives \$741 in extra housing services per year. In the Section 236 piggy-back program, the average quantity of extra housing consumed is \$1,729.

Another important issue is whether the tenant family is living in better housing under the program than it would have in the absence of the program. On the basis of a sample of tenants and information on how low-income persons

²⁵The term "housing problems" refers either to having inadequate housing or to paying an excessive share of the family budget for adequate housing.

TABLE 18

MONTHLY RENT COMPARISON ⁽¹⁾

LOCATION	CENSUS MEAN GROSS RENT, 1970	RENTER COSTS FAMILY OF FOUR BLS LOWER BUDGET, 1972	AVERAGE 236 MARKET RENT, 1972 - 1973	
			NEW	REHAB.
BOSTON	\$135	\$124	\$272	\$225
WASHINGTON, D.C.	134	117	239	219
PITTSBURGH	110	90	251	238
ST. LOUIS	97	94	249	NA
SAN FRANCISCO	144	130	249	NA
NATIONAL AVERAGE	\$118	\$103 ⁽²⁾	\$208 ⁽³⁾	

NA = NOT AVAILABLE.

(1) INCLUDING UTILITIES.

(2) METROPOLITAN AREAS ONLY.

(3) BASED ON NEW ADMISSIONS, OCTOBER 1, 1971 TO SEPTEMBER 30, 1972.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING AND DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS.

spend their incomes, it is possible to determine how the program affects the tenant's level of housing. This computation was performed only for the Section 236 program without rent supplement. The average tenant family improves its housing services 51 percent under the program. Expenditures on other goods, however, are virtually unaffected. These results indicate that the program is having the desired impact on the families served -- at least in terms of housing. These families are receiving a substantial quantity of "extra housing" and this addition represents a major shift in the quality of housing they occupy, without loss of other goods.

Although society as a whole may be benefited by this sharp improvement in housing relative to other goods, the individual Section 236 family may prefer instead a subsidy that consisted of somewhat less housing and more of other goods. For example, if the tenant family were given a cash grant equal to the housing subsidy, it might elect to spend only 30 percent on housing and the other 70 percent on other goods. The inflexible nature of the transfer-in-kind mandated under the program results in the subsidy being worth less than its cash value to the tenant. The average cash grant equivalent for Section 236 families is approximately \$526, roughly 70 percent of the market value of the extra housing provided. The cash grant that the tenant would require in exchange for his Section 236 rent supplement subsidy is substantially larger in dollar terms, but is not larger when measured against the extra housing provided. The estimated cash grant is \$1,106 -- roughly 65 percent of the market value of the extra housing provided to Section 236 rent supplement families.

COSTS: Besides direct subsidy payments, there are four other costs which must be considered in determining the actual total cost to the Federal Government of a Section 236 unit (Table 19). In the case of limited dividend sponsors, the tax shelter inducements reduce Federal tax revenues and thus impose a budgetary cost. The GNMA Tandem Plan subsidy and HUD administrative costs must also be taken into account. Finally, the insurance losses caused by the financial failure of projects must be measured. Many of these costs occur irregularly. To facilitate cost-benefit analysis, a fair share of these costs should be allocated to the year being studied. The technique used is to determine the extent of the irregular costs over the life of a project, discount those costs to the initial year, and, finally, amortize the sum of those costs over the life of the project.

TABLE 19

ANNUAL COSTS PER SECTION 236 UNIT, 1972

COST ITEM	236	236 RENT SUPPLEMENT
DIRECT SUBSIDY (INCLUDING INSURANCE PREMIUM)	\$956	\$1,975
FORECLOSURE COSTS (NET OF INSURANCE INCOME)	\$29	\$29
ADMINISTRATIVE COSTS	\$16	\$16
SUBTOTAL	\$1,001	\$2,020
TAX REVENUE FOREGONE (LIMITED DIVIDENDS ONLY)	\$99	\$99
TOTAL	\$1,100	\$2,119

For units completed through 1972, GNMA Tandem Plan losses were relatively small and can be ignored. This situation may change in the future because of recent deviations between the FHA ceiling and the going market rate of interest for mortgages. Administrative expenditures are also small. It costs \$139 in HUD personnel time and overhead to initiate a program unit under Section 236. It costs another \$6 a year to monitor the unit. Amortized at a 6 percent discount rate over 35 years (the estimated subsidy life of a typical unit), administrative costs are only \$16 a year.

Tax revenue losses for Section 236 projects are a result of several tax shelter inducements. First, certain construction period expenses can be taken as immediate deductions rather than capitalized in the project mortgage for future depreciation. Second, during the operation of the project, the cost basis of the project may be depreciated on an accelerated basis.²⁶ This usually results in an artificial loss which can shelter other income of the taxpayer-investor. The high loan-to-value ratio and low cash equity required for a Section 236 project provide the investor-taxpayer with a greater ratio of depreciation dollar losses to equity invested than for a conventional project. Third, upon transfer of a Section 236 project, the rate of taxation of gain can be more favorable than for other real property. Moreover, the tax on such gain can be deferred if the project owners transfer it in accordance with the "rollover provision" of the Internal Revenue Code. (For a fuller discussion, see Chapter 2.)

Estimates of the tax revenue forgone to induce the participation of limited dividend sponsors were made.²⁷ The

²⁶The Administration's new tax proposal would sharply diminish the advantages of taking accelerated depreciation. Although this change would reduce the revenue loss of limited dividend projects, it would also eliminate a major inducement for participation in the program, since sponsors depreciate their investments rapidly in the first few years, thereby substantially offsetting income from the project or, more importantly, other investments or activities.

²⁷The tax revenue forgone from all tax shelter advantages, including those available to the conventional builders, was estimated. It was assumed that, in the absence of the program, other tax shelter activity would not have expanded. This overstates to some extent the taxes forgone by reason of the program because in the absence of the program investors would have sought other tax "shelter."

estimates vary with the assumptions about the availability and rate of return of other tax shelters and the typical point at which a sponsor will sell a project to maximize his returns. A reasonable estimate is that forgone tax revenue -- or, from the standpoint of the sponsors, tax savings -- for a typical Section 236 limited dividend unit may total \$1,446.²⁸ Amortized at 6 percent over 35 years, the average annual tax loss per limited dividend unit was \$99 (Table 19).

Estimates of the losses due to insurance claims on the FHA Special Risk Fund were also made. If these losses are allocated over all units and amortized, the annual cost per unit is \$86. Adding this loss to other program costs would involve some double counting, however. The direct subsidy payment includes an insurance payment which the Government, in essence, makes to itself. Adjusting for this premium income, the annual net foreclosure cost per unit is \$29.

EFFICIENCY: Is subsidized housing competitive in price? In 1971, HUD's audit office reviewed Section 236 projects in 21 cities. Each project was matched with two similar conventional projects and the "market rents" for the Section 236 units were compared to rents of conventional units with the same number of bedrooms. The rents were adjusted for differences in amenities. The survey data indicate that the market rents of the Section 236 units were 10 percent higher than conventional rents. No adjustments were made for differences in neighborhood quality, but it was the opinion of those conducting the survey that such adjustments would have increased the disparity in rents.

The HUD audit survey is consistent with the results of a special study of construction costs in three regions undertaken in June, 1973. This study shows that it cost \$3 per square foot more -- 20 percent -- to build a subsidized unit than to construct a similar conventional unit.

With information on both costs and benefits, it is possible to determine the efficiency of the program. One important question is how much cost is incurred by the Government to provide the "extra housing" to the tenant. This relationship, which has been defined as Production Efficiency, will differ between Section 236 units with rent supplements and regular Section 236 units and between units in limited dividend projects and units in nonprofit projects. Results for all four possibilities are reported in Table 20.

²⁸Future income was discounted in computing the sum.

PRODUCTION EFFICIENCY OF THE SECTION 236 PROGRAM, 1972

236 WITHOUT RENT SUPPLEMENT NON-PROFITS AND COOPERATIVES LIMITED DIVIDENDS	.74 .67
236 RENT SUPPLEMENT NON-PROFITS AND COOPERATIVES LIMITED DIVIDENDS	.86 .82

4-67

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

As Table 20 shows, Production Efficiency varies from .67 to .86. The lower efficiency for limited dividend sponsors may not be accurate because limited dividend projects seem to have better foreclosure experience. It was not possible to make separate foreclosure cost estimates for limited dividend sponsors.

Production inefficiency can arise from two sources: (1) the indirect costs that accompany the subsidy payments, such as administrative costs and forgone tax revenue, and (2) inefficiency in transforming the subsidy payment into extra housing for the recipient. The second source accounts for more than 60 percent of the total Section 236 inefficiency. Earlier it was noted that the "market rent" of Section 236 units is approximately 10 percent more than the rent of similar conventional units. This inefficiency is magnified by a production strategy which requires a family to move into a newly constructed unit rather than to upgrade its present unit. For example, consider a family living in a \$120 apartment whom society wishes to house in a unit worth \$200. If its present unit could be satisfactorily improved by repairs and modernization worth \$80, an inefficiency of 10 percent in making such improvements would make the direct cost to the Government \$88. However, the Section 236 program does not improve housing in this way. Instead, the family moves into a subsidized project where a unit which would cost \$200 if built for the conventional market costs the Government \$220. If the family continues to pay a rent of \$120, then the direct cost to the Government to improve the family's housing by \$80 is \$100. The inefficiency is 25 percent rather than 10 percent.

The Production Efficiency estimates for the Section 236 rent supplement program are lower because of the deeper subsidy. In the above example, the unit cost the Government \$20 more than it was worth. If the subsidy were deeper (for example, if the family's rent were only \$90), then this absolute loss would be spread over a larger transfer. It would cost the Government \$130 to provide \$110 worth of housing, an inefficiency of only 18 percent.

The Transfer Efficiency estimates show that the average Section 236 tenant implicitly values his transfer-in-kind at only 71 percent of its market value and the average Section 236 rent supplement tenant implicitly values his transfer-in-value at only 64 percent of its market value.

Finally, Program Efficiency indicates how much overall benefit tenants receive in relation to the costs incurred by the Government (Table 21). This ratio ranges from .48 to .55. In other words, for every \$100 in expenditures or tax revenues forgone, the Federal Government improves tenant welfare only \$48 to \$55.

PROGRAM VIABILITY: It is difficult to predict with accuracy what experience the Section 236 program will have with respect to mortgage foreclosures and assignments. Data exist on the program's five years of operation and other data can be obtained for a similar program (Section 221(d)(3) below market interest rate rental housing) through the first 10 years of operation. After that point, forecasts must be based on the experience of an unsubsidized FHA multifamily program (Section 207). The evidence available suggests that approximately 20 percent of all units will fail within the first 10 years. Over 40 years, the life of mortgages issued under the program, the failure rate may be 30 percent or more. This longer-run prediction is obviously less reliable since it is based on the experience of a non-subsidized FHA program (Section 207).

As of December 31, 1972, HUD owned six Section 236 projects and held assigned mortgages on 60 more, about 2 percent of all insured projects. No foreclosed Section 236 projects had as yet been sold, so that estimates of loss in turnover must be based on the experience of another subsidized program. For the Section 221(d)(3) below market interest rate program, the average loss on the acquisition and sale of a unit was approximately 45 percent of the acquisition costs. These projects were held for periods of up to three years and, on the average, rental receipts failed to cover operating costs and maintenance expenditures.

THE RENT SUPPLEMENT PROGRAM

Although not a production program itself, the rent supplement program is always used in conjunction with Government housing production programs. These include the Section 221(d)(3) market-rate program, Section 236, Section 221(d)(3) below market-rate, and Section 231 insurance for multifamily projects serving the elderly or handicapped. Section 236 piggy-backs were discussed earlier and because the Section 221(d)(3) below market-rate and Section 231 combinations are rare, this section will deal exclusively with the combination of rent supplement and the Section 221(d)(3) market-rate program.

TABLE 21

SECTION 236 EFFICIENCY, 1972

TYPE OF SPONSOR	PRODUCTION	TRANSFER	PROGRAM
236 WITHOUT RENT SUPPLEMENT			
NON-PROFITS, COOPERATIVES	.74	.71	.53
LIMITED DIVIDENDS	.67	.71	.48
236 RENT SUPPLEMENT			
NON-PROFITS, COOPERATIVES	.86	.64	.55
LIMITED DIVIDENDS	.82	.64	.52

The Section 221(d)(3) market-rate program does not, by itself, subsidize the production of multifamily housing. It does, however, provide important inducements to build such housing -- a high loan-to-value ratio, a 40 year mortgage, mortgage insurance, special tax advantages, and, in some cases in the past, Tandem Plan assistance.

The rent supplement provides the subsidy in the form of a contract through which the Government agrees to make monthly rent payments on behalf of the tenant. In exchange, the landlord agrees to obtain HUD approval of rent changes. To be eligible for a rent supplement subsidy, a family must earn, at initial occupancy, less than the local limit for admission to low-rent public housing. In addition, the family must satisfy one or more hardship criteria such as (1) having an elderly or handicapped head or spouse; (2) having a veteran or member of the armed forces; or (3) having been displaced from an urban renewal location.

Each unit has an "economic rent" which is the sum necessary to cover the operating and capital costs associated with that unit. The tenant is required to pay 25 percent of his income or 30 percent of the "economic rent," whichever is greater. Income is adjusted for family size and tenant rent cannot exceed the "economic rent."

Table 22 provides some basic background information on the program.

MAJOR FINDINGS

1. The rent supplement program serves mainly low-income households.
2. Sizable subsidies are provided to rent supplement tenants while many low-income households receive no assistance. The rent supplement program serves less than 1 percent of all households earning less than \$4,000 per year.
3. There is evidence that the "economic rent" for a Section 221(d)(3) market-rate rent supplement unit is higher than rents for similar units in the private market.
4. Federal costs exceed the market value of the housing provided by approximately 30 percent in the Section 221(d)(3) market-rate rent supplement program.

TABLE 22

CHARACTERISTICS OF THE RENT SUPPLEMENT PROGRAM, 1972

UNITS ASSISTED THROUGH DECEMBER 31, 1972 ⁽¹⁾ (FINALLY ENDORSED)	77,000
TOTAL MORTGAGE AMOUNTS THROUGH DECEMBER 31, 1972 ⁽¹⁾ (FINALLY ENDORSED)	\$1.0 BILLION
MAXIMUM ANNUAL SUBSIDIES PERMITTED BY LAW THROUGH FISCAL YEAR 1973 (CONTRACT AUTHORITY RELEASED IN APPROPRIATIONS)	\$280 MILLION
UNITS IN PROCESS AND UNITS FINISHED PROCESSING AT THE END OF FISCAL YEAR 1973 ⁽²⁾ (RESERVATIONS AND OBLIGATIONS OF CONTRACT AUTHORITY)	119,000
MEDIAN INCOME OF NEW TENANTS	\$2,400
RACIAL AND ETHNIC COMPOSITION OF NEW TENANTS:	
NON-MINORITY WHITE	44%
BLACK	44%
SPANISH AMERICAN	6%
OTHER	6%

(1) EXCLUDES UNITS IN SECTION 236 PROJECTS. EXCLUDES UNITS FINANCED THROUGH STATE AND LOCAL PROGRAMS AND NOT INSURED BY FHA (SEE CHAPTER 5). INCLUDES ALL UNITS IN OTHER RENT SUPPLEMENTED PROJECTS EVEN WHERE SOME UNITS MAY NOT RECEIVE A RENT SUPPLEMENT.

(2) EXCLUDES UNITS IN SECTION 236 PROJECTS. EXCLUDES UNITS FINANCED THROUGH STATE AND LOCAL PROGRAMS AND NOT INSURED BY FHA (SEE CHAPTER 5).

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

5. The main reason Federal costs exceed market value is that Section 221(d)(3) market-rate rent supplement units are not rent competitive with identical private units and therefore the direct subsidy is spent inefficiently. Forgone tax revenue, administrative costs, and foreclosure costs also contribute to the excess of costs over housing value.
6. Forecasts indicate that about 30 percent of all Section 221(d)(3) market-rate rent supplement units will fail in the first 10 years. The program does not appear to be actuarially sound.

EQUITY: Table 23 shows that most tenants benefiting from the rent supplement program have very low incomes, 82 percent of them below \$4,000 annual income. The probability of being served by the program (Column 4) declines as income increases, but the differences are probably too small to be significant. The rent supplement program is able to serve low-income groups for two reasons. First, the subsidy formula allows the Government to subsidize a larger share of the rent, thus requiring a smaller contribution on the part of the tenant. Secondly, units built under the Section 221(d)(3) market-rate program are simpler in amenities than the typical Section 236 unit. In 1971, the average Section 221(d)(3) market-rate mortgage was \$13,818 compared to \$16,304 under Section 236.

Column 6 of Table 23 shows that the average subsidy increases slightly and irregularly with income.

Horizontal equity is again a problem in the sense that the rent supplement program provides extensive benefits to a relatively few families while most receive no assistance. Table 23, Column 5 shows that there are 13.1 million families unserved with annual income under \$4,000. There are two ways to solve this equity problem -- either the rent supplement program can be funded at a substantially higher level, or an alternate technique can be found that will provide assistance to more families but at less cost per family. Table 24 indicates for a sample of four cities, the extent to which the "economic rent" for the typical Section 221(d)(3) market-rate unit exceeds the rent for the average private unit or the unit satisfying the housing needs specified in the Bureau of Labor Statistics lower budget for a family of four. Even taking into account that the economic rent frequently overstates the quality of the unit (see below), these units are of higher quality than the average private unit.

TABLE 23

DISTRIBUTION OF RENT SUPPLEMENT (EXCLUDING 236 RENT SUPPLEMENT) HOUSING, BY INCOME CLASS

(1)	(2)	(3)	(4)	(5)	(6)
GROSS INCOME	HOUSEHOLDS SERVED BY RENT SUPPLEMENT		RENT SUPPLEMENT HOUSEHOLDS AS PERCENT OF ALL HOUSEHOLDS	RESIDUAL NEED *	DIRECT ANNUAL SUBSIDY PER HOUSEHOLD SERVED
	NUMBER	PERCENT DISTRIBUTION			
\$0 - 999	2,150	2.8%	.13%	—	\$1,342
1,000 - 1,999	24,200	31.9	.63	1,800,000	1,427
2,000 - 2,999	19,740	26.0	.46	5,300,000	1,503
3,000 - 3,999	15,870	20.9	.40	9,300,000	1,511
4,000 - 4,999	8,850	11.7	.23	13,100,000	1,582
5,000 - 5,999	3,540	4.7	.09	16,700,000	1,773
6,000 - 6,999	1,170	1.5	.03	20,300,000	1,845
7,000 - 7,999	330	.4	LESS THAN .005%	23,700,000	1,744
8,000 - 9,999	120	.2	LESS THAN .005%	27,400,000	1,738
10,000 OR MORE	30	LESS THAN .05%	LESS THAN .005%	34,600,000	1,392

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

* NUMBER OF HOUSEHOLDS LIVING IN UNSUBSIDIZED HOUSING EARNING LESS THAN LOWER LIMIT FOR THAT INCOME CLASS, AS GIVEN IN COLUMN 1.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NOS. 84 AND 87, AND 1970 CENSUS OF POPULATION.

MONTHLY RENT COMPARISONS⁽¹⁾

LOCATION	CENSUS MEAN GROSS RENT, 1970	RENTER COSTS FAMILY OF FOUR BLS LOWER BUDGET, 1972	AVERAGE 221 (0) (3) MR ECONOMIC RENT 1972 - 1973 (2)
BOSTON	\$135	\$124	\$205
WASHINGTON, D.C.	134	117	186
PITTSBURGH	110	90	163
ST. LOUIS	97	94	191

(1) INCLUDING UTILITIES.

(2) NEW CONSTRUCTION ONLY.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING AND DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS.

IMPACT: The average rent supplement subsidy in combination with the Section 221(d)(3) market-rate program is \$1,300 per year. This deeper subsidy combined with a less costly unit results in the Government paying a larger share of the total unit rent than is the case under Section 236, 55 percent compared to 40 percent.

One notable consequence of the deeper subsidy is that the tenant receives more housing services. The average annual transfer-in-kind is \$1,087. In other words, the tenant receives about \$90 more housing per month than he purchases with his own rent. However it cannot be determined how much the rent supplement subsidy alters the normal consumption pattern of a recipient family. Data comparable to that used in the Section 236 analysis do not exist. Similarly, there is no information on how much value the tenant attaches to his subsidy and, as a result, it cannot be determined how much impact the program has on his welfare.

COSTS: In addition to the direct subsidy, there are four other costs which must be considered in calculating the total costs to the Federal Government in providing this transfer-in-kind. These are: (1) Tandem Plan subsidies; (2) administrative costs; (3) insurance claims; and (4) forgone tax revenue (Table 25).

Here, as in the Section 236 program, all cost and benefit data refer to projects completed prior to December 31, 1972. For those projects, GNMA Tandem Plan subsidies were minimal and can be ignored. HUD's internal reporting system collects information on administrative costs for the Section 221 program as a whole. Because this includes data on unsubsidized projects and due to certain other shortcomings, it seems better to rely on the Section 236 administrative cost data as an indication of costs under the Section 221(d)(3) market-rate program.

Computer simulation of the rent supplement program suggests that the subsidy will be in effect for the full 40 years of the contract. Therefore, the initial administrative costs have been amortized over 40 years. These costs plus the annual monitoring costs total only \$15 per year.

Because of a higher failure rate, insurance claims are projected to be larger under the rent supplement Section 221(d)(3) market-rate program than under Section 236. The extra 5 years of subsidy life temper this increase somewhat. The annual per unit allocation of foreclosure costs is \$115. After adjustment for premium income, the annual per unit cost is \$70. Here, as in the case of the Section 236 program, the

TABLE 25

**ANNUAL COSTS PER SECTION 221 (D) (3) MARKET-RATE
RENT SUPPLEMENT UNIT, 1972**

COST ITEM	AMOUNT
DIRECT SUBSIDY (INCLUDING INSURANCE PREMIUM)	\$1,300
FORECLOSURE COSTS (NET OF INSURANCE INCOME)	\$70
ADMINISTRATIVE COSTS	\$15
SUBTOTAL	\$1,385
TAX REVENUE FOREGONE	\$92
TOTAL	\$1,477

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

foreclosure calculations imply that the present insurance premium is not large enough to cover anticipated losses over the life of the program.

Limited dividend sponsors of Section 221(d)(3) market-rate enjoy the same tax advantages given to Section 236 sponsors. Because of the lower development cost per unit and the longer period over which to amortize the cost, the average annual cost estimate for forgone tax revenue under the Section 221(d)(3) market-rate program is \$92, compared to \$99 under Section 236.²⁹

EFFICIENCY: The rent supplement program is always combined with a production program, usually either Section 221(d)(3) market-rate or Section 236. Therefore, the effectiveness of the rent supplement program depends on the price competitiveness of the Government-sponsored housing program which it supplements.

As reported in analyzing the Section 236 program, construction costs average 20 percent more for federally subsidized multifamily projects than for conventional units of equal quality. This estimate was obtained from a sample which included both Section 236 and Section 221(d)(3) market-rate units.

The most useful measure of competitiveness is a rent comparison. The "economic rent" of a rent supplement unit is the monthly income necessary to cover the cost of building and operating the unit. If the economic rent is higher than the rent for an identical unit on the private market, then the production program is inefficient and the impact of the rent supplement subsidy is reduced. To make this rent comparison, data on Section 221(d)(3) market-rate units in four cities were collected and compared with private rents for similar units in these cities. These results suggest that Section 221(d)(3) market-rate units are as competitive as Section 236 units. Therefore, the audit finding that Section 236 rents are 10 percent higher than rents on the private market could be applied to the Section 221(d)(3) market-rate rent supplement program as a reasonable approximation.

A series of factors may explain the higher rents observed in both the Section 236 and the Section 221(d)(3) market-rate programs. FHA processing, as a result (at least

²⁹Forgone tax revenue was estimated in the same manner as in the case of the Section 236 program.

in part) of the numerous statutory requirements, involves significant paperwork and causes delays at the initiation stage, adding to costs. There are undoubtedly instances where the Government has permitted higher land costs or service fees than are typical in conventional building. The Davis-Bacon requirement may increase labor costs in some markets. Concentration of low-income families may raise operating costs. Better loan terms, particularly with regard to length of mortgage, partially offset these other factors.

Lack of price competitiveness has a double impact on the rent supplement program. First, the Government subsidy buys less housing. Secondly, the tenant's own rent contribution is inefficient. Accordingly, part of the subsidy payment must reimburse the tenant for the loss of efficiency in his own payment. The remaining subsidy is used to buy extra housing for the tenant.

Having estimated the extra housing provided and the various costs incurred, it is possible to measure Production Efficiency. For non-profit and cooperative sponsors, the costs incurred were those involving the direct subsidy, administrative costs, and foreclosure costs. These totaled \$1,385 which when divided into the extra housing provided (\$1,087) yields a Production Efficiency of .78. In the case of limited dividend sponsors, forgone tax revenue is also included among the costs. The Production Efficiency ratio then becomes .74. Thus for every \$100 in tax revenue (expended directly or forgone indirectly), the Government can provide between \$74 and \$78 of extra housing under the Section 221(d)(3) market-rate rent supplement program.

It was not possible to estimate Transfer Efficiency for the rent supplement program. If the estimate obtained for Section 236 rent supplement (.64) is used, the overall Program Efficiency can be estimated. The ratio of benefits, determined on the cash-grant-equivalent basis discussed earlier, to total cost is in the range of .47 to .50. This means that through the rent supplement Section 221(d)(3) market-rate program, the Government increases tenant welfare by only \$47 to \$50 for every \$100 in costs or forgone taxes.

PROGRAM VIABILITY: The longer operating experience of the Section 221(d)(3) market-rate program provides a better data base for estimating foreclosures than was available for the Section 236 program. It is estimated that during the first 10 years of insured life, approximately 30 percent of all Section 221(d)(3) market-rate projects will fail. Projections

further into the future must rely on the experience of unsubsidized FHA multifamily housing and, therefore, may be much less reliable. The percentage of financial failures over forty years -- the full term of a Section 221(d)(3) mortgage -- is estimated to be approximately 40 percent.

As in the case of the Section 236 program, no foreclosed Section 221(d)(3) market-rate property had as yet, been sold. To estimate the Government's loss in the acquisition and sale of foreclosed properties, it was necessary to use the experience of another subsidized program, Section 221(d)(3) below market interest rate. The Government loses approximately 45 percent of the acquisition price on the turnover of these properties. As in the case of the Section 236 program, rent receipts from foreclosed projects are insufficient to cover their operating costs and maintenance expenditures.

The high failure rates reflect the riskiness of the undertaking. Concentrating low-income families in one project tends to create problems which add to the costs of operating and maintaining a multifamily structure.

LOW RENT PUBLIC HOUSING

The low rent housing program had its origins in the United States Housing Act of 1937 -- although Federal involvement in the field began somewhat earlier basically as an anti-Depression measure to stimulate employment.

Under the provisions of the 1937 Act, the Government and local housing authorities (known as LHA's) were responsible for all aspects of developing and operating the project. The Government's role was to provide the amounts necessary to amortize the full capital costs of the projects. Tenant rents were to pay for the full cost of operating the project. Such costs included only a payment-in-lieu-of-taxes since the project was exempt from local property taxes.

However, in recent years Congress has amended the original statute to authorize additional Federal payments in the form of operating subsidies in order to meet deficits caused by the statutory limitations on tenant rent discussed below and by increasing operating costs.

Several other significant changes have been made in the development of public housing. Under Section 23 of the 1937 Act added in 1965, local housing authorities were

permitted to lease private units, which they, in turn, sublet to public housing tenants. Some of these leases cover existing units. Others cover newly constructed units built on the basis of lease commitments.

Another modification in the development of public housing projects was implemented in 1967 when the local authorities were authorized, after advertisement, to purchase a project located on a site selected by the developer and built by the developer according to his specifications. Since 1970, more than half of all public housing units entered the program through this so-called "turnkey" mechanism.

In addition in 1967 HUD developed a program to provide additional annual contributions to amortize the cost of modernizing older public housing projects.

The most significant recent change in the public housing program came through a statutory amendment in 1969 which limits the rent a tenant may pay for a public housing unit to 25 percent of his annual adjusted income, no matter how low that may be. This amendment and accompanying provisions regarding the computation of income have been partly responsible for multiplying the Federal Government's operating subsidy payments nine-fold from \$31 million in Fiscal Year 1970 to \$280 million in Fiscal Year 1973.

By the end of 1971, there were about one million public housing units occupied by more than three million persons. In 1971, the cost of the services provided by public housing units was about \$2.3 billion. Public housing tenants paid 26 percent of this cost; Federal and local governments bore the remaining 74 percent. Only 42 percent of the cost borne by government appears explicitly in HUD appropriations and expenditures records. Another 36 percent of the cost to government is attributable to the tax exempt status of the interest earned on local authority bonds, and another 22 percent is attributable to the difference between full local property taxes and the smaller payments made by local housing authorities to local governments in lieu of taxes.

MAJOR FINDINGS

1. Families served by public housing are on average poorer than those not served. However, most of the families in the lowest income groups are not served while many families with higher incomes are served.

2. Among families living in public housing, average benefits tend to be larger for the poorest families. However, there is great variation in the value of the program to families having similar incomes.
3. The average public housing unit is almost as good as the average private rental dwelling in a sample of seven major cities. Many public housing units are worse than the average private rental unit but almost an equal number are better.
4. The overwhelming majority of public housing tenants occupy better housing and are able to purchase more of other goods than they would in the absence of the program.
5. Taxpayers incurred an average annual cost of \$1,650 per household in public housing.
6. Tenant welfare is increased by only about 55 cents for every dollar spent because resource costs to produce public housing are greater than those required to produce comparable conventional housing, and because tenants place a lower value on the transfer-in-kind than a cash grant.
7. In 1971, it cost \$1.03 to produce a dollar's worth of housing services under the leased program, \$1.23 under the "turnkey" program, and \$1.40 under the conventional program.

EFFECTS ON CONSUMPTION PATTERNS: One of the most important effects of any government housing program is its effect on the quality of the housing occupied by participants. How much better or worse housing do public housing tenants occupy than they would occupy in the absence of the program?

In an effort to provide an answer, the market values of public housing units -- the rents they would command on the open market -- and the market rents of private housing units that the occupants would have occupied in the absence of the program were estimated. The estimates were based on three different samples. One sample consisted of data collected on 1,388 families living in conventional public housing in seven cities. The second sample drawn from six cities consisted of 326 families living in conventional public housing and 30 families living in "turnkey" public housing. A third sample consisted of 120 families

living in conventional public housing, 120 in existing leased housing, 47 in new leased housing, 24 in new "turnkey" units and 24 in existing units acquired for public housing in five cities. All data were for 1971.

The estimates of the effects of public housing on the quality of housing based on these samples are shown in Table 26. The similarity of the results from the different samples is striking. The analysis shows that public housing tenants on average occupy significantly better housing than they would in the absence of the program. The percentage improvement in housing (valued at market rates) ranged between 82 and 59 percent for the three different samples. The overwhelming majority -- 87 percent in the five-cities sample and 92 percent in the six-cities sample -- experienced improvement in their housing.

The rent that a family in public housing pays may be more or less than the amount that it would have spent on housing in the absence of the program. Hence, the family's expenditure on other goods may be affected by the public housing program. The three studies provide information estimating the effect of public housing on the expenditures for other goods and services. Estimates of increased expenditures on non-housing goods and services ranged from 5 percent to 19 percent. A majority -- 76 percent in the five-cities sample and 92 percent in the six-cities sample -- increased their expenditures on non-housing goods.

VALUE OF PUBLIC HOUSING TO ITS OCCUPANTS: Table 28 shows that the average benefit to occupants of public housing ranged between \$76 and \$52 per month. The average benefit as a percentage of income ranged from 11 to 26 percent, demonstrating that public housing tenants receive considerable benefits from the program.

COST OF PUBLIC HOUSING TO THE GOVERNMENT: On the basis of the six-cities sample, estimated costs of providing such benefits per dwelling unit were \$193 per month. The mean rent paid by tenants was \$56 per month. Therefore, the cost to taxpayers per dwelling unit was \$137 per month. This cost includes the forgone taxes attributable to the tax exempt status of the interest earned on local authority bonds and the exemption of these projects from local property taxes.

DISCREPANCY BETWEEN THE COST OF PUBLIC HOUSING TO GOVERNMENT AND ITS VALUE TO TENANTS: Government provides \$137 per month per family in public housing to support the low rent public housing program. However, the benefit as viewed by the public

TABLE 26

EFFECT OF LOW RENT PUBLIC HOUSING ON TENANT HOUSING, 1971

SAMPLE NAME	SEVEN CITIES	SIX CITIES	FIVE CITIES	COMBINED
SAMPLE SIZE	(1,388)	(356)	(335)	—
MEAN MONTHLY MARKET VALUE OF PUBLIC HOUSING UNITS	\$146	\$157	\$156	\$149
MEAN MONTHLY HOUSING EXPEND- ITURE IN THE ABSENCE OF THE PROGRAM	\$80	\$92	\$98	\$85
PERCENTAGE INCREASE IN HOUSING	82%	71%	59%	75%

TABLE 27

EFFECT OF LOW RENT PUBLIC HOUSING ON TENANT NON-HOUSING EXPENDITURES, 1971

SAMPLE NAME	SEVEN CITIES (1,388)	SIX CITIES (356)	FIVE CITIES (335)	COMBINED
SAMPLE SIZE				-
AVERAGE MONTHLY EXPENDITURE ON NON-HOUSING GOODS AND SERVICES BY PUBLIC HOUSING TENANTS	\$166	\$258	\$376	\$216
AVERAGE MONTHLY EXPENDITURE ON NON-HOUSING GOODS AND SERVICES IF THE TENANTS WERE NOT IN PUBLIC HOUSING	\$140	\$222	\$357	\$189
PERCENTAGE IN- CREASE IN EXPENDITURES ON OTHER GOODS	19%	16%	5%	14%
MEAN MONTHLY TENANT RENT IN PUBLIC HOUSING	\$54	\$56	\$79	\$58
MEAN MONTHLY INCOME	\$220	\$314	\$455	\$274

MAGNITUDE OF BENEFITS TO LOW RENT PUBLIC HOUSING TENANTS AND COSTS TO TAXPAYERS, 1971

SAMPLE NAME	SEVEN CITIES	SIX CITIES	FIVE CITIES	COMBINED
SAMPLE SIZE	(1,388)	(356)	(335)	-
MEAN MONTHLY BENEFIT TO PUBLIC HOUSING TENANTS	\$57	\$76	\$52	\$59
MEAN MONTHLY INCOME	\$220	\$314	\$455	\$274
PERCENTAGE INCREASE IN REAL INCOME	26%	24%	11%	22%
MONTHLY COST TO TAXPAYERS	NA	\$137	NA	NA

NA = NOT AVAILABLE.

housing tenant is \$76 per month, meaning that Program Efficiency is .55. This discrepancy results from a number of factors. First, \$9 per unit per month is required to administer the program, excluding management costs that would be incurred by private producers of housing service. Second, an additional \$27 per month is due to technical inefficiency in producing housing service under the public housing program. Finally, another \$25 per month is lost because tenant welfare is not increased commensurately with the dollars spent since the subsidy forces tenants to purchase housing and other goods in combinations they would not choose in the absence of the program.

TECHNICAL EFFICIENCY: An estimated \$184 per month per dwelling unit is spent on providing housing service under the program without considering administrative costs. It is also estimated that the structural characteristics and city location (excluding neighborhood considerations) are such that the mean market value of the unit is \$157 per month. That is, on the average public housing tenants would find private housing with a rent of \$157 per month as satisfactory as their public housing units. Therefore, under this measure, public housing authorities spend \$1.17 to produce one dollar's worth of housing, meaning that Technical Efficiency is .85. This technical inefficiency in producing housing service accounts for \$27 per month per dwelling unit of the discrepancy between the cost of public housing to taxpayers and its value to tenants.

There are marked differences in the efficiency with which housing services are produced under the various types of public housing. A study published by the Joint Economic Committee of Congress estimated that the full cost per dwelling unit per month of leased, "turnkey" and conventional public housing in 1971 was \$154, \$211, and \$219 respectively.³⁰ Pooling the data from two other samples designed by the National Housing Policy Review, the market values per dwelling unit per month were estimated at \$149, \$172, and \$156 under the leased, "turnkey," and conventional

³⁰Frank de Leeuw and Sam H. Leaman, "The Section 23 Leasing Program," in Joint Economic Committee of Congress, The Economics of Federal Subsidy Programs, Part 5 - Housing Subsidies, Washington, D.C.: Government Printing Office 1972. The de Leeuw-Leaman study does not take into account any differences in average desirability of the public housing units provided by the three different methods.

public housing programs respectively. Based on that data, it costs \$1.03 to produce a dollar's worth of housing service under the leased program, \$1.23 under the "turnkey" program, and \$1.40 under the conventional program. The relative efficiency with which housing service is produced under the leased program can be attributed to its use of the existing stock.³¹

ADMINISTRATIVE COST: Any housing subsidy program has administrative costs in addition to the management costs of providing housing services. The cost of checking the eligibility of applicants for public housing is an example of such an administrative cost. The cost of administering the program, as opposed to managing the housing, is estimated at \$9 per month. These costs result in no benefits to public housing tenants (at least in terms of housing).

TRANSFER EFFICIENCY: Public housing tenants on the average occupied housing with a market value of \$157 per month and spent \$258 per month on other goods. Hence, the average market value of all goods consumed by these families was \$415 per month. Since the average income of these families was \$314 per month, the public housing program resulted in an increase of \$101 per month per family in the market value of all goods consumed. Since the cost to government is \$137 per month per family in public housing, the Production Efficiency is .74.

Under the public housing program, the consumer is not free to choose among all combinations of goods with the same market value as the combination actually produced by the public housing program. As a result, the value of the program to tenants averages \$76 per month rather than \$101. That is, ignoring technical inefficiency, the public housing program is only 75 percent as efficient as unrestricted cash grants in providing benefits to its occupants. The Transfer Efficiency is .75 which accounts for \$25 per month per dwelling unit of the discrepancy between the cost of public housing to the government and its value to tenants.

³¹Estimates of the relative efficiency of leased public housing include construction-for-leasing units and existing leased units. Data limitations did not permit measurements of the relative efficiency of each program type separately. The average \$1.03 cost to produce a dollar's worth of housing services under the leased program likely understates the cost of construction-for-leasing units while it overstates the cost of existing leased units.

EQUITY: Families served by public housing on the average are poorer than those not served by public housing. In 1971 the median annual income of all families in the United States was about \$10,000, while at the same time it was about \$3,000 for families occupying public housing. Furthermore, among families living in public housing, average benefits tend to increase as family income decreases. This is indicated in Table 29.

Approximately 50 percent of the families in public housing have annual incomes in excess of \$3,000 (Table 30). Meanwhile, 95 percent of all families in the United States with annual incomes of less than \$3,000 are not served by the program.

Among low-income families that do occupy public housing, there is a large variation in the value of the program. About one-third of families having similar incomes receive benefits of \$30 per month more or less than the average benefits. For example, if the average benefit for a similar group of families is \$70 per month, then about one-third of the families would receive benefits of less than \$40 or more than \$100 per month.

Table 31 compares estimates of the average market values of public housing units with estimates of the average market value of all housing in several cities. The value of the average public housing unit is almost equal to the average private rental dwelling. The average public housing tenant is occupying housing at least equivalent to that occupied by lower-middle-income families. Furthermore, this improvement in the housing of public housing tenants rarely occurs at the expense of their consumption of other goods. On the contrary, they typically have more to spend on non-housing goods and services.

A study by the Rural Housing Alliance and the Housing Assistance Council indicates that large differences occur in the ratio of public housing units to the number of poverty-level households according to the degree of urbanization in an area. In metropolitan counties with high population densities there is a public housing unit for every five poverty-level households.³² In high-density non-metropolitan counties there are nine households in poverty for every public housing

³²Rural Housing Alliance and Housing Assistance Council, Public Housing: Where It Is and Isn't, Washington, D.C., December 1972.

TABLE 29

THE DISTRIBUTION OF BENEFITS AMONG LOW RENT PUBLIC
HOUSING TENANTS, BY INCOME CLASS, 1971

GROSS INCOME	MEAN ANNUAL BENEFIT TO PUBLIC HOUSING TENANTS
\$0 - 999	\$ 696
1,000 - 1,999	900
2,000 - 2,999	1,044
3,000 - 3,999	1,008
4,000 - 4,999	972
5,000 - 5,999	648
6,000 - 6,999	708
7,000 - 7,999	504
8,000 OR MORE	624

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,
NATIONAL HOUSING POLICY REVIEW.

TABLE 30

**DISTRIBUTION OF LOW RENT PUBLIC HOUSING BY INCOME CLASS,
AS OF DECEMBER 31, 1972**

GROSS INCOME	TOTAL HOUSEHOLDS	HOUSEHOLDS SERVED BY PUBLIC HOUSING	PUBLIC HOUSING HOUSEHOLDS AS PERCENT OF ALL HOUSEHOLDS
\$0 - 999	1,800,000	25,910	1.5%
1,000 - 1,999	3,800,000	283,120	7.4
2,000 - 2,999	4,300,000	248,520	5.8
3,000 - 3,999	4,000,000	183,860	4.7
4,000 - 4,999	3,800,000	124,290	3.2
5,000 - 5,999	3,800,000	73,260	2.0
6,000 - 6,999	3,600,000	45,760	1.3
7,000 - 7,999	3,800,000	27,900	.7
8,000 OR MORE	39,600,000	42,420	.1
TOTAL	68,500,000	1,055,050	1.5%

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NOS. 84 AND 87, AND 1970 CENSUS OF POPULATION.

TABLE 31

MONTHLY RENT COMPARISONS, 1970 *

LOCATION	LOW RENT PUBLIC HOUSING MARKET VALUES	CENSUS MEAN GROSS RENT
BALTIMORE	\$113	\$116
BOSTON	125	135
LOS ANGELES	117	128
PITTSBURGH	92	110
ST. LOUIS	103	97
SAN FRANCISCO	133	144
WASHINGTON, D.C.	136	134

* INCLUDING UTILITIES.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING.

unit. The discrepancy is greater still for those metropolitan counties with lower population densities. They average about 11 poverty-level households for every public housing unit. Most pronounced is the gap in non-metropolitan counties with low population densities, where such counties have more than 16 poverty-level households for every public housing unit. Essentially, the same disparities occur between the number of public housing units and the number of units which lack complete plumbing and/or are overcrowded.

FARMERS HOME ADMINISTRATION SECTIONS 502 AND 504 PROGRAMS

The FmHA has the responsibility under the Housing Act of 1949 to provide "safe, decent, and sanitary" housing for rural residents, and it tries to meet this objective largely through the Section 502 homeownership program and the Section 504 homeownership repair program. The Section 502 program accounts for about 96 percent of all FmHA housing outlays. The Section 515 rural rental and Section 514/516 farm labor housing programs are not reviewed here because of the limited data available.

The Section 502 loan program provides loans to rural families who indicate they cannot obtain credit from conventional sources to build new homes or to buy or improve existing houses. Loans made during Fiscal Year 1972 bore a 7 1/4 percent interest rate with an amortization period of up to 33 years. Interest credit loans are made to lower-income families (less than \$7,000 adjusted annual income). The amount of interest credit granted depends upon the size and income of the family and the amount of the loan. The family must pay at least one percent interest. In 1972 the maximum interest credit was 6 1/4 percent. Because FmHA lends at 7 1/4 percent and borrows at a different rate -- determined by the going rates in secondary mortgage markets where it sells notes -- there can be an additional interest premium subsidy both to interest credit borrowers and moderate income non-interest credit borrowers. In Fiscal Year 1972, the estimated average annual interest credit subsidy was \$658, and the estimated average interest premium subsidy was \$152. The major characteristics of the Section 502 program are shown in Table 32.

The Section 504 loans are made to owner occupants to make minor home repairs in order to remove hazardous living conditions. These loans are for "below standard" housing in contrast to the standard housing financed

TABLE 32

CHARACTERISTICS OF THE SECTION 502 PROGRAM, FISCAL YEAR 1972

CHARACTERISTICS	NON-INTEREST CREDIT	INTEREST CREDIT
FAMILY CHARACTERISTICS:		
MEAN INCOME	\$7,900	\$5,400
MEAN NUMBER OF PERSONS	3.7	4.2
MEAN AGE OF HEAD	32	36
	PERCENT OF TOTAL	
RACIAL AND ETHNIC COMPOSITION:		
NON-MINORITY WHITE	87%	68%
BLACK	11	26
SPANISH-SPEAKING	2	5
PURPOSE OF LOAN:		
BUILD OR PURCHASE NEW	49	85
REPAIR OR PURCHASE OLD	41	15
TYPE OF WASTE DISPOSAL:		
INDIVIDUAL WASTE SYSTEM	75	66
PUBLIC SEWER	25	34
LOCATION:		
OPEN COUNTRY	52	52
TOWNS UP TO 2,500	26	24
TOWNS 2,500 - 5,499	14	15
TOWNS 5,500 - 9,999	8	9
FARM	4%	
NON-FARM	96	

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW BASED ON DATA FROM DEPARTMENT OF AGRICULTURE.

under Section 502 loans. Section 504 loans bear an interest rate of 1 percent and are repayable in up to 10 years. The maximum loan is \$3,500. In Fiscal Year 1972, the estimated average interest subsidy was \$75 per loan.

MAJOR FINDINGS

1. Taken separately the income group most likely to be served by Section 504 was \$1,000-\$1,999, by Section 502 interest credit \$4,000-\$4,999, and by Section 502 non-interest credit \$8,000-\$8,999.
2. Current financing methods result in an interest premium subsidy on all Section 502 loans, not just interest credit loans.
3. The Sections 502 and 504 programs result in substantial improvements in housing quality. The recipients substantially increase their expenditure on housing and decrease their expenditures on other goods and services.
4. The annualized administrative cost of making and servicing a Section 502 non-interest credit loan was approximately 60 percent of the estimated subsidy.
5. The Section 502 interest credit program increases borrower welfare on a cash grant equivalent basis by approximately seventy cents for every dollar of Federal cost.
6. The FmHA's provision of counseling, appraisals, inspections, closing services, and loan servicing results in low foreclosure losses, but relatively high administrative costs.
7. Although current programs can serve lower income families within the range of income groups now being served through administrative action by FmHA, the basic problems inherent in the production and subsidy in-kind approach would remain.

EQUITY: Table 33 shows the distribution by annual family income of Section 502 interest credit, Section 502 non-interest credit and Section 504 loans. Legislative intent is not specific regarding the particular income groups to be served by the programs.

Judging by program data from Fiscal Year 1972, the Section 504 program serves income groups in the \$1,000 to \$4,000 income classes.

TABLE 33

DISTRIBUTION OF SECTIONS 502 AND 504 LOANS, BY INCOME CLASS, LOANS MADE FISCAL YEAR 1972^(A)

(1) GROSS INCOME	(2) NUMBER OF RURAL FAMILIES	(3) CUMULA- TIVE NUMBER OF RURAL FAMILIES	(4) PERCENT DISTRI- BUTION OF RURAL FAMILIES (B)	(5) HOUSEHOLDS SERVED BY 502 IC LOANS		(7) HOUSEHOLDS SERVED BY 502 NIC LOANS		(8) HOUSEHOLDS SERVED BY 502 NIC LOANS		(10) HOUSEHOLDS SERVED BY 504 LOANS		(12) HOUSEHOLDS SERVED BY 504 LOANS		(13) CONCENTRA- TION RATIO (COL12÷COL4)
				NUMBER DISTRI- BUTION	PERCENT DISTRI- BUTION	NUMBER DISTRI- BUTION	PERCENT DISTRI- BUTION	NUMBER DISTRI- BUTION	PERCENT DISTRI- BUTION	NUMBER DISTRI- BUTION	PERCENT DISTRI- BUTION	NUMBER DISTRI- BUTION	PERCENT DISTRI- BUTION	
\$0- 999	450,000	450,000	5.1%											.6
1,000-1,999	726,000	1,176,000	8.3	3,575	6.1%	.3		260	.6%	1,216	39.1			4.7
2,000-2,999	838,000	2,014,000	9.6							960	30.8			3.2
3,000-3,999	873,000	2,887,000	10.0	7,187	12.3	1.2		504	1.1		15.0			1.5
4,000-4,999	873,000	3,760,000	10.0	12,857	22.1	2.2		1,194	2.5		7.5			.8
5,000-5,999	981,000	4,741,000	11.2	13,608	23.3	2.1		2,804	6.0		2.7			.2
6,000-6,999	999,000	5,740,000	11.4	11,701	20.1	1.8		6,341	13.5		1.1			.1
7,000-7,999	1,044,000	6,784,000	11.9	7,508	12.9	1.1		11,800	25.2		.5			UNDER .05
8,000-8,999	1,048,000	7,832,000	12.0	1,727	3.0	.2		15,165	32.3		.2			UNDER .05
9,000-9,999	930,000	8,762,000	10.6	131	.2	UNDER .05		6,506	13.9		.0			.0
10,000 OR MORE	(B)	(B)	(B)	0	.0	—		2,307	4.9		.0			—
TOTAL	—	—	100.0%	58,294	100.0%	—		46,881	100.0%		100.0%			—

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

(A) COVERS 48 CONTIGUOUS STATES.

(B) NO FAMILIES ARE SHOWN IN THE \$10,000 OR MORE CLASS IN ORDER TO ALLOW SUITABLE COMPARISONS WITH THE SUBSIDIZED PROGRAMS.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION.

The concentration of Section 502 interest credit loans is in the \$4,000 to \$7,000 income range with the greatest concentration in the \$4,000 to \$5,000 income group. However, 2.9 million rural families with annual incomes of less than \$4,000 cannot be served, given the present Section 502 program structure and the rural income distribution. Of these, approximately 2.5 million families (86 percent) are occupying substandard housing, according to Department of Agriculture estimates. Families earning less than \$4,000 annually can be served by the Section 502 interest credit program in the Southeast and Southwest where housing costs and taxes are comparatively low, and elsewhere by utilizing rehabilitated or existing units that average approximately \$2,000 less in cost than new units on a nationwide basis. But if the program experiences increasing construction costs and continues to emphasize new units, the \$4,000 income class will effectively be the lowest class served by the program.

The concentration of Section 502 non-interest credit loans is in the \$7,000 to \$9,000 annual income range and the concentration begins falling for incomes above the \$9,000 level. If the \$6,000 level can be taken as an effective limit, there are approximately 4.7 million families that cannot be served by the non-interest credit program.

The percentage of any income class that is served by the program is a measure of horizontal equity. Table 34 indicates that for the programs combined, the highest percentage of eligible recipients served by loans made in 1972 is 1.85 percent for the \$7,000 to \$8,000 annual income class. This measure assumes that those not served want to be served, especially because there is a large backlog of applications on hand in FmHA county offices. Using only loans made in 1972 does not account for those served by the program before Fiscal Year 1972, but given that the Fiscal Year 1972 loan volume accounted for a substantial proportion of all loans ever made, it is apparent that only a small percentage of those eligible could have been served over the years..

Overall, the Sections 502 and 504 programs are concentrated in the Southwest and the Southeast as indicated in Table 35. A ratio of concentration greater than 1 indicates that a larger percentage of loans go to a region than the percentage of eligible population that the region contains.

The inability of the current programs to serve lower income levels, more families at any given income level and a wider geographic base results in part from budgetary

TABLE 34

**PERCENT OF ELIGIBLE FAMILIES SERVED BY SECTIONS 502 AND 504 LOANS,
LOANS MADE FISCAL YEAR 1972^(A)**

(1) GROSS INCOME	(2) NUMBER OF RURAL FAMILIES	(3) 502 IC HOUSEHOLDS		(5) 502 NIC HOUSEHOLDS		(7) 504 HOUSEHOLDS		(9) 502 AND 504 HOUSEHOLDS AS PERCENT OF ALL RURAL FAMILIES (COLS. 4+6+8)
		NUMBER SERVED BY LOANS	AS PERCENT OF ALL RURAL FAMILIES	NUMBER SERVED BY LOANS	AS PERCENT OF ALL RURAL FAMILIES	NUMBER SERVED BY LOANS	AS PERCENT OF ALL RURAL FAMILIES	
\$0- 999	450,000	3,575	.18 %	260	.01 %	95	.02 %	.30 %
1,000-1,999	726,000					1,216	.17	
2,000-2,999	838,000					960	.11	
3,000-3,999	873,000	7,187	.82	504	.06	467	.05	.93
4,000-4,999	873,000	12,857	1.47	1,194	.14	233	.03	1.64
5,000-5,999	981,000	13,608	1.39	2,804	.29	83	.01	1.68
6,000-6,999	999,000	11,701	1.17	6,341	.63	35	UNDER .005	1.81
7,000-7,999	1,044,000	7,508	.72	11,800	1.13	17	UNDER .005	1.85
8,000-8,999	1,048,000	1,727	.16	15,165	1.45	6	UNDER .005	1.61
9,000-9,999	930,000	131	.01	6,506	.70	0	.00	.71
10,000 OR MORE	(B)	0	—	2,307	—	0	—	—
TOTAL	—	58,294	—	46,881	—	3,112	—	—

(A) COVERS 48 CONTIGUOUS STATES.

(B) NO FAMILIES ARE SHOWN IN THE \$10,000 OR MORE CLASS IN ORDER TO ALLOW SUITABLE COMPARISONS WITH THE SUBSIDIZED PROGRAMS.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION.

(A)
SECTIONS 502 AND 504 REGIONAL DISTRIBUTION, LOANS MADE FISCAL YEAR 1972

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
HUD REGION	PERCENT OF RURAL FAMILIES (B)	502 INTEREST CREDIT LOANS		502 NON-INTEREST CREDIT LOANS		504 LOANS	
		PERCENT DISTRIBUTION	CONCENTRATION RATIO (COL. 3+COL. 2)	PERCENT DISTRIBUTION	CONCENTRATION RATIO (COL. 5+COL. 2)	PERCENT DISTRIBUTION	CONCENTRATION RATIO (COL. 7+COL. 2)
I	5.1%	4.3%	.8	3.0%	.6	2.2%	.4
II	6.2	1.9	.3	4.0	.6	.5	.1
III	13.4	10.1	.8	9.8	.7	7.7	.6
IV	24.7	38.5	1.6	29.8	1.2	39.8	1.6
V	21.2	12.4	.6	20.5	1.0	2.8	.1
VI	10.5	13.6	1.3	14.9	1.4	38.3	3.6
VII	7.7	6.2	.8	8.1	1.1	5.9	.8
VIII	3.4	2.7	.8	4.4	1.3	2.2	.6
XI	4.1	6.0	1.5	2.2	.5	.4	.1
X	3.7	4.3	1.2	3.4	.9	.3	.1
TOTAL	100.0%	100.0%	1.0	100.0%	1.0	100.0%	1.0

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING. SEE TABLE 10 FOR STATE COMPOSITION OF THE REGIONS.
(A) COVERS 48 CONTIGUOUS STATES.

(B) INCLUDES FAMILIES IN ALL INCOME CLASSES.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW ESTIMATES BASED ON DATA FROM DEPARTMENT OF AGRICULTURE AND DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION.

levels, the depth of the subsidies, and the administration of the program. But it is more fundamentally a function of the program structure and the emphasis on the production of new units. The present programs provide relatively large amounts of housing services to a limited number of families.

IMPACT: Table 36 presents estimates of the extent to which the Section 502 and the Section 504 programs have improved the quality of housing, the effects of the programs on non-housing consumption, and the amount of benefits and subsidies transferred by the Government to Section 502 and 504 borrowers. Evaluated on the basis of whether there was an increase in housing quality, each program was successful. The improvement in housing conditions in terms of consumer welfare ranged from 48 percent for the non-interest credit program to 85 percent for the interest credit program.

An improvement in housing sometimes comes at the expense of expenditures on other goods. This happened in each of the FmHA programs; the decrease in expenditures on non-housing goods and services ranged from minus 3 percent in the Section 502 interest credit program to minus 9 percent in the Section 504 program. Upon entering the programs, recipients generally increased the share of their income spent on housing to such an extent that they had less left over for non-housing expenditures.

Inevitable in any transfer-in-kind strategy is the difference between the market value of the subsidy transferred and the recipient's evaluation of the worth of the subsidy. Table 36 shows first how much the recipient values the subsidy he receives, and second, how much the market values it.

In the case of the non-interest credit Section 502 borrower, the actual subsidy dollars (\$92) were little valued (\$30) by the consumer, yet the borrower gave up 7 percent of his expenditures on other goods upon entering the program. This indicates that while the subsidy dollars themselves provide little housing value to the Section 502 non-interest credit borrower, the ability to obtain credit on better terms than otherwise available may be of more consequence than the subsidization of that credit. It further may imply that prior to having access to FmHA credit, the borrower was unable to purchase as much housing as he would have desired if credit were available at rates and terms similar to FmHA rates and terms. The estimated value of the subsidy to the consumer does not measure the value of the access to credit and consequently may not be a full measure of benefit.

TABLE 36

IMPACT - CONSUMER WELFARE, FISCAL YEAR 1972

IMPACT	502		504
	INTEREST CREDIT	NON-INTEREST CREDIT	
PERCENT CHANGE IN HOUSING	85	48	NA
PERCENT CHANGE IN NON-HOUSING	-3	-7	NA
MEAN MONTHLY BENEFIT	\$47.21	\$2.47	NA
MEAN ANNUAL BENEFIT	\$567	\$30	NA
PERCENT CHANGE IN REAL INCOME	10.8	0	NA

IMPACT - MARKET EVALUATION, FISCAL YEAR 1972

IMPACT	502		504
	INTEREST CREDIT	NON-INTEREST CREDIT	
PERCENT CHANGE IN HOUSING	92	57	54
PERCENT CHANGE IN NON-HOUSING	-3	-7	-9
MEAN MONTHLY SUBSIDY	\$57.92	\$7.67	\$6.28
MEAN ANNUAL SUBSIDY	\$695 *	\$92 *	\$75.30
PERCENT CHANGE IN REAL INCOME	11.8	1.2	3.2

NA = NOT AVAILABLE.

* THESE ESTIMATES FROM A SAMPLE SURVEY ARE BELOW DEPARTMENT OF AGRICULTURE ESTIMATES FROM NATIONAL PROGRAM DATA OF \$810 AND \$152 RESPECTIVELY.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

Another question raised in evaluating the impact of the Section 502 program is whether there are indirect benefits for those not receiving direct subsidies. A National Housing Policy Review survey was undertaken in four rural areas, two of which were growing in population and two of which were not, to assess whether there were indirect benefits accruing to occupants of housing units previously occupied by Section 502 borrowers.³³ Indirect benefits would result if successive occupants obtained better quality housing for the same or less rent than previously paid. It would further be necessary to show that the benefits would not have occurred without the program.

The results of the survey did not substantiate the existence of indirect benefits for the programs in the areas sampled. There was no significant difference between the incomes of those in succeeding links of the chain at 3 of the 4 sites surveyed. There also was no significant change in housing quality without a simultaneous increase in expenditure for housing. Consequently, recipients did not receive higher quality housing without paying more.

COSTS: In addition to the average direct interest subsidy of \$658 and the average interest premium subsidy of \$152, the FmHA incurs two other costs -- losses from foreclosure and administrative costs of the program.

The FmHA charges no insurance premium to either Section 502 interest credit or Section 502 non-interest credit borrowers. Consequently any losses on foreclosure are absorbed by the Rural Housing Insurance Fund. The yearly cost of foreclosures is estimated to be approximately \$7 per Section 502 non-interest credit unit and \$5 per Section 502 interest credit unit. The administrative costs have been estimated at \$91 per year for a Section 502 non-interest credit loan and \$113 per year for a Section 502 interest credit loan. Included in these costs are the amortized costs of appraisal, inspection and closing, and the annual cost of servicing the loan.

EFFICIENCY: The Technical, Production, Transfer, and Program Efficiencies for the Section 502 program are computed

³³Louis, Bowles, and Grove, Inc., "The Filtering Effects of Subsidized Rural Housing," a study prepared for the National Housing Policy Review, Department of Housing and Urban Development, July 20, 1973.

below. The subsidy estimates used for the calculations were derived from a sample of 200 Section 502 loans in each of the ten regions. The National Housing Policy Review subsidy estimates are lower than the FmHA estimates from national data. Other Government costs were derived from national data. The market value of a unit was estimated as the sum of the borrower's payment and the interest credit and interest premium subsidies.

Technical Efficiency is the relationship between the market value of the unit and the cost to the Government including subsidy, foreclosure losses and administrative costs plus the payment by the individual. It is assumed that the market value and the cash cost to produce the unit are identical, that is, that there are no inducements in the program leading to excessive construction costs.

Technical Efficiency:	502 Non- Interest Credit	502 Interest Credit
<u>Market Value of Unit</u>	= \$1604	\$1719
<u>Total Gov't Cost + Occupant Cost</u>	\$1702	\$1837
	= .94	= .94

Production Efficiency is the ratio of the market value of the subsidy to the cost to the Government of providing it. For the Section 502 non-interest credit program Production Efficiency is relatively low because the administrative cost per year is large relative to the subsidy. For the Section 502 interest credit program the administrative cost is similar, but provides a much larger subsidy so its Production Efficiency is higher.

Production Efficiency:	502 Non- Interest Credit	502 Interest Credit
<u>Market Value of Subsidy</u>	= \$92	\$695
<u>Total Government Cost</u>	\$190	\$813
	= .48	= .85

Transfer Efficiency is the relation between the cash-grant-equivalent value to the recipient of the government subsidy and the actual amount of that subsidy. The low Transfer Efficiency reported for the Section 502 non-interest credit program is the best estimate available but is not as statistically reliable as the estimates reported for the other programs.

Transfer Efficiency:	502 Non- Interest Credit	502 Interest Credit
<u>Cash Value of Subsidy</u>	= \$30	\$567
<u>Subsidy</u>	\$92	\$695
	= .33	= .82

Program Efficiency is the product of Production and Transfer Efficiency. Section 502 non-interest credit has low program efficiency because both Production and Transfer Efficiencies are low. Therefore, the foregoing qualification on the reliability of Transfer Efficiency also applies to Program Efficiency.

Program Efficiency:	502 Non- Interest Credit	502 Interest Credit
<u>Cash Value of Subsidy</u> =	.16	.70
<u>Total Government Cost</u>		

These estimates indicate that one dollar of Government expenditure is worth 16 cents in the Section 502 non-interest credit program and 70 cents in the 502 interest credit program as evaluated by the measures defined above. For these programs to be more efficient other benefits must be present. As noted above for the Section 502 non-interest credit program, one of these benefits may be the increased availability of credit.

APPENDIX

SPECIAL ISSUES

IMPACT ON THE HOUSING STOCK

Of crucial importance in evaluating the success of the subsidized housing programs is the effect of the housing programs on the quantity and quality of the housing stock.³⁴ The main statutory objective of the housing programs to provide a "decent home and a suitable living environment for every American family" can be met in only two ways, either by increasing the total stock of housing or by redistributing the housing available from those who have more than a "decent home" to those who do not have a "decent home".

Production programs attempt to increase the stock of housing and reduce the effective price of housing to certain low-income families. The housing condition of the subsidized population are certainly improved. However, not every subsidized unit represents a net addition to the Nation's housing stock for the following reasons:

1. The production of subsidized housing requires private mortgage credit (in the case of public housing, bonds are issued), and some portion of the credit for subsidy programs is bid away from unsubsidized buyers who must, therefore, reduce their consumption of housing.
2. The subsidy itself must be financed either by raising additional taxes or by increased government borrowing. Both financing methods tend to reduce consumption or investment elsewhere in the economy and some of the reduction in spending will be at the expense of other (unsubsidized) housing.
3. The analysis of the subsidized housing programs shows that subsidized housing is inefficiently provided. If it were provided more efficiently, fewer resources would be drawn from the mortgage market, and less taxes or government borrowing would be necessary. Therefore, additional resources would be available for subsidized and unsubsidized construction.

³⁴For brevity the term "housing stock" will be used on the following pages to denote both the quantity and quality dimensions of housing.

In summary, the provision of housing subsidies undoubtedly increased the quantity and quality of housing for those relatively few who were subsidized while it reduced the construction of new housing units for everyone else. On balance, there has probably been a net addition to the housing stock because of the subsidies, but the addition is equal only to a portion of the total number of units that were subsidized. The exact addition is difficult to estimate, but various analyses suggest for every 100,000 units subsidized during the 1960's and early 1970's perhaps as few as 14,000 represent net additions to the housing stock.³⁵ Housing construction expenditures are probably increased proportionately less than the total number of subsidized units constructed because these units tend to be smaller than the average unit constructed in the economy.

Therefore, the subsidy programs probably provide very little stimulus to aggregate housing expenditures in the economy as a whole.

STIMULATING THE ECONOMY

The subsidized housing programs were created to enable lower income families to enjoy decent housing at a reasonable price to the recipient. In this chapter each program has been evaluated in terms of its success in achieving this goal. Some secondary impacts have also been identified and analyzed, such as the impact of subsidized housing on racial integration.

Another issue is the contribution, if any, which subsidized housing makes to maintaining a high level of economic activity. Simply stated, the thesis implicit (and sometimes

³⁵Craig Swan, op. cit., Frank de Leeuw, "Market Effect of Moderate Income Construction Subsidies," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973. The Swan paper estimated that the net addition was 14,000 units for every 100,000 units subsidized. The analysis did not explicitly take into account the need to finance the subsidy with tax increases or debt issues, although the need to finance subsidies may have had an effect on the results. The de Leeuw paper implicitly considered financing for the 235 and 236 programs and estimated that this effect alone reduced unsubsidized starts by an amount equal to one-half of the number of subsidized starts (e.g., 50,000 net addition for each 100,000 units subsidized).

explicit) in housing legislation enacted to date is that the production of subsidized housing provides jobs and increased income in the construction industry and, subsequently, in other industries as the initial increase in income is spent. The net effect is, allegedly, a higher level of economic activity than would have existed in the absence of the program.

This reasoning is incorrect because it attributes to one small section of the Federal budget a characteristic of the entire budget. By its management of taxes and expenditures, the Federal Government does have a stimulating or depressing effect on the level of economic activity. However, this effect depends on the overall budget deficit or surplus and not on the individual tax or expenditure items which make up that deficit or surplus. The argument fails to consider what could or would happen in the absence of the subsidized housing programs. Presumably, other Federal expenditures would have been made, taxes reduced, or less debt issued, reducing pressure on credit markets. All of these alternatives would also have stimulated economic activity and, therefore, there need be no net increase or net decrease in national income simply because the Government chose to subsidize or not to subsidize housing.³⁶

The Federal Government's choice between subsidized housing and other expenditures or a tax reduction may have an impact on the level of activity in the construction industry. If, instead, the Federal funds had been spent on educational aids for schools in low-income areas, the initial employment and income effect would have occurred in the school supply industry rather than the construction industry. The overall effect would be the same, the only difference being the point of incidence.³⁷

³⁶The theory of the "Balanced-Budget Multiplier" argues that a tax reduction matched by an equal reduction in government spending would reduce national income. However, more detailed analysis suggests that national income may be unaffected if the government's expenditure were a substitute for consumer purchases.

³⁷The analysis in this section assumes that subsidized housing programs do not replace conventional residential building. To the extent that this assumption is false, the stimulating impact on the construction industry is diminished. If there were an overall impact on the economy, it would also be lessened.

HOMEOWNERSHIP FOR THE POOR

Although homeownership has long been encouraged by a variety of Federal laws, no major programs offering homeownership to the poor in the 20th century were enacted until the 1960's. Since that time, the problems which have arisen from the operation of those programs -- principally the Section 235 and Section 221(d)(2) programs -- are so serious as to raise questions about the validity of the concept itself.

If homeownership for the poor is a feasible concept, a principal justification for Government programs to achieve this objective would be the existence of significant market imperfections in the economy, which prevent the low-income family from purchasing the optimum quantity and quality of housing. Building codes, racial discrimination, deed restrictions, zoning and taxes all discourage low-income families from buying homes.

The housing strategy embodied in the existing housing statutes does not permit low cost homes to be produced or even legally to exist in many areas.³⁸ In addition, the deductibility of mortgage interest and property taxes biases the advantages of homeownership in favor of higher-income families because of their higher marginal tax rates. A case can thus theoretically be made that a proper role of Government is to redress this imbalance and to create incentives for low-income families to purchase their own homes.

In the 1930's, books were written questioning the desirability of homeownership with such titles as "Homeownership: Is it Sound?" Even today, major textbooks in real estate are careful to point out that homeownership is not appropriate for every family, especially if its income is low. And when one carefully delineates the multidimensional commodity or investment called a "home" and examines each dimension in light of the needs and characteristics of the poor, no clear answer emerges as to whether homeownership is a net benefit or a net burden to low-income families.³⁹

³⁸See, for a discussion on how the U.S. housing strategy differs from strategies adopted in other countries, Anthony Downs, "Housing the Urban Poor: The Economics of Various Strategies," American Economic Review, September 1969, pp. 646-656.

³⁹For a more complete discussion see Peter Marcuse, "Homeownership for Low-Income Families: Financial Implications," Land Economics, May 1972, pp. 134-143.

For example, housing as an investment for low-income individuals is illiquid, risky, requires complex management, and has high maintenance costs. A savings account is a safer and more liquid investment and one which requires little monitoring and expertise. Low-income families, because their incomes tend to be less stable and because of high transaction costs, particularly benefit from flexible tenure. In addition, their lesser amounts of discretionary time and management skills put them at a disadvantage relative to higher-income families.

Ownership also exposes the owner-occupant to the hazards of unexpectedly expensive repairs, especially in low-cost new housing in which too often long-run durability has been sacrificed for low initial cost.⁴⁰ To some extent, rental tenancy spreads such hazards over many families. Hypothetically, a landlord will compute his average maintenance and repair expenditures over the anticipated period of his ownership, divide by the number of units and the number of months, and charge that amount per month for maintenance. While hardly an insurance policy, the risk is nevertheless thus spread out among a number of units, and funded over an extended period of time.

There is little empirical support for the often expressed view that a homeowner acquires a new dignity or that becoming a homeowner automatically transforms a person. The evidence of the social and psychological impact of homeownership is mostly anecdotal, especially as it concerns low-income families. The favorable impact may sometimes occur; the point is that studies to date do not verify such a phenomenon as the usual social result. In addition, no research has separated the ownership aspect from associated dimensions including, among others, single-family dwelling unit and location.⁴¹

⁴⁰Committee on Housing Research and Development, Families in Public Housing, Urbana: University of Illinois, 1972.

⁴¹For a summary of what is known on the social benefits of homeownership for the poor see Georges Vernez and Robert K. Yin, Rand Corporation, "Social Aspects of Federal Low-Income Housing Programs," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, August 1973.

CHAPTER 5

HOUSING ACTIVITIES OF STATE AND LOCAL GOVERNMENTS

In the early years of this century, the location, character and quantity of housing in the United States was almost exclusively a matter of individual determination regulated -- if at all -- by local government jurisdictions acting increasingly, as such devices became popular, through planning and zoning boards.

The trauma of the Depression dealt a blow to the tradition of exclusive local control and private responsibility for housing; it brought about the participation of the Federal Government, which began to promote the construction of housing first through indirect stimulants to home financing and then through direct programs of support.

Impelled by the burgeoning demands for additional municipal services imposed by rapid growth and concerned about escalating property tax rates, local governments in recent years have expanded their role in housing and community development. They have responded to the challenge of unrestricted growth by establishing growth limits, setting sewer moratoria and enacting exclusionary zoning ordinances to control further large-scale residential development while they evaluate its potential impact on the environment and the character of their communities.

Over the past decade, State governments have emerged as a significant force in the housing field with the formation of a variety of new state housing agencies holding broad charters to undertake a wide range of activities aimed at upgrading the living conditions of State residents. The States have also begun to reassert their authority in land use policy. Land use control, until recently, was almost entirely a local function although, in principle, State governments have an inherent power to control and regulate the use of land as part of their mandate to protect public health, safety and welfare. Municipalities, however, through the device of planning and zoning boards which became popular in the second decade of this century, not only established construction criteria but also determined neighborhood characteristics, growth patterns and the proportions of single-family detached homes, multiple family dwellings, stores, offices and industrial facilities.

As population growth intensified the competition for a variety of land uses and broadened the scale of that competition, a role for the States was clearly indicated.

Many States are adopting tough environmental control standards to preserve areas of natural beauty and maintain open space. Some are attempting to override local building and housing codes.

States initiatives have sometimes taken the form of encouraging regional planning for future land use. In other cases, States have moved to exclude development on certain types of land, such as coastal wetlands. State activity has also encompassed the establishment of comprehensive development goals governing projects extending across several local jurisdictions. The Federal Government is now moving, through legislation under consideration in the Congress, to promote such State initiatives by providing assistance for State and regional development of land use policy.

The new coordinating role of State government also is illustrated in the field of building and housing codes. For some time it has been recognized that the maze of conflicting building and housing codes operated by local governments represents an impediment to lowering the cost of housing construction. To remedy this, numerous States have adopted or are attempting to adopt uniform statewide code legislation, usually based on national or regional model codes. The States also have begun to offer their planning expertise and services to understaffed small and medium-sized communities so that they can better cope with the problems of community development.

In all, what seems to be evolving is a new cooperation between Federal, State and local governments in establishing and fulfilling the housing policies of the Nation. Moreover, intergovernmental financial relationships, which influence housing policies, also appear to be changing. Federal financial assistance -- including revenue sharing -- has added to the resources available to the States and local governments, permitting them if they choose to expand their activities in housing assistance, regional planning, and environmental control.

But in spite of the significant expansion of State and local roles in housing and community development, progress has been very uneven. The fact that some States and municipalities have progressed in these fields should not obscure the wide range of differences. Indeed, the historical pattern

of development of State and local public administration in the United States is that some jurisdictions tend to move relatively rapidly while others lag behind for prolonged periods -- even with strong Federal incentives.

STATE GOVERNMENT ACTIVITIES IN HOUSING

STATE FINANCE AND DEVELOPMENT AGENCIES

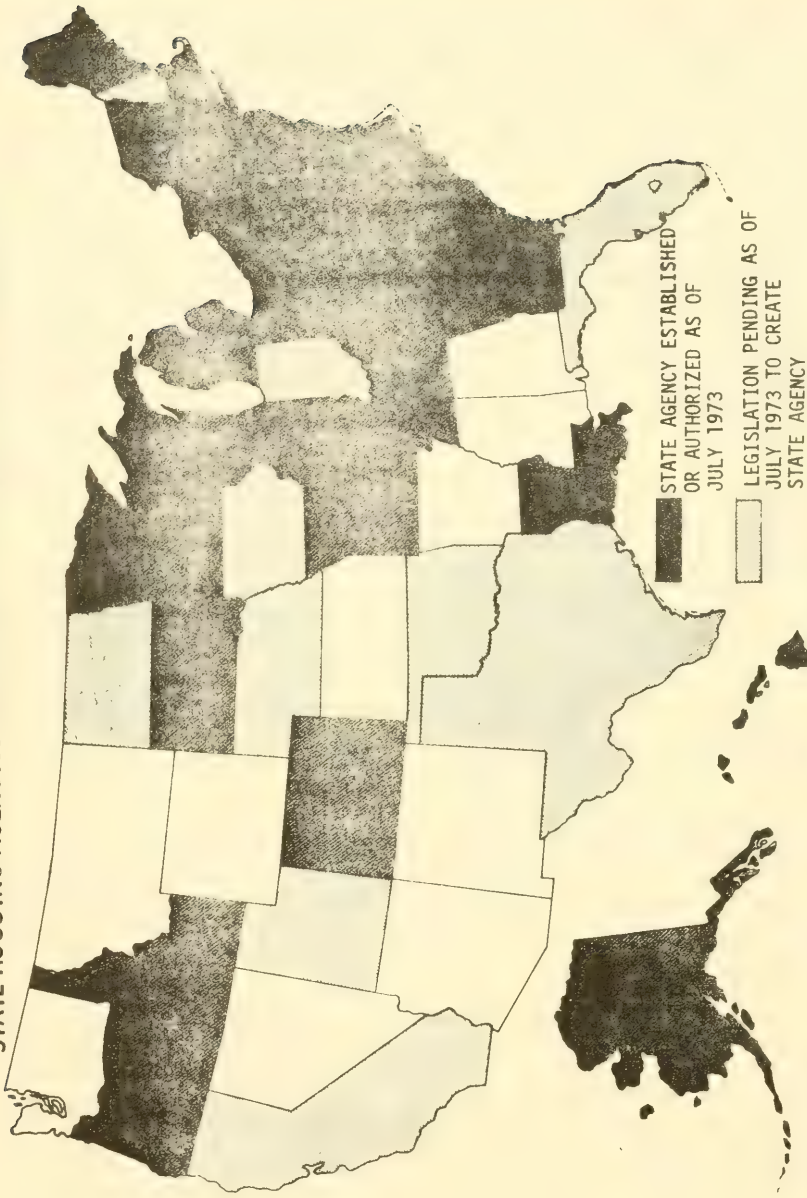
The emergence of State governments as a force in promoting the development of housing is a fairly recent phenomenon. Partially in response to Federal housing programs enacted in the latter part of the 1960's, the States have been establishing their own housing finance and development agencies and community affairs agencies to facilitate the planning and construction of housing within their borders and to deal with many of the concomitant factors involved in housing production.

As of 1960 there was only one State Housing Finance Agency -- in New York. In the late 1960's, 11 were established. From 1970 to 1972 14 additional States set up housing finance agencies. With the enactment of legislation this year in Colorado, Rhode Island, South Dakota and Tennessee, there are now 30 States with housing finance or development agencies (New York State has two such agencies). Another 10 States are considering legislation to establish such agencies. (Charts 1 and 1a)

The primary function of State finance agencies has been to provide financial assistance for the construction of housing for low- and moderate-income families. Most of them play an active role in the development of housing, usually in partnership with private developers, who do the actual building or rehabilitation work. Nevertheless, the finance agencies participate in site selection and acquisition, design review, and the determination of size and number of units in a given project. They establish the nature and extent of supporting community facilities, and set standards for equal opportunity, employment and marketing of the housing.

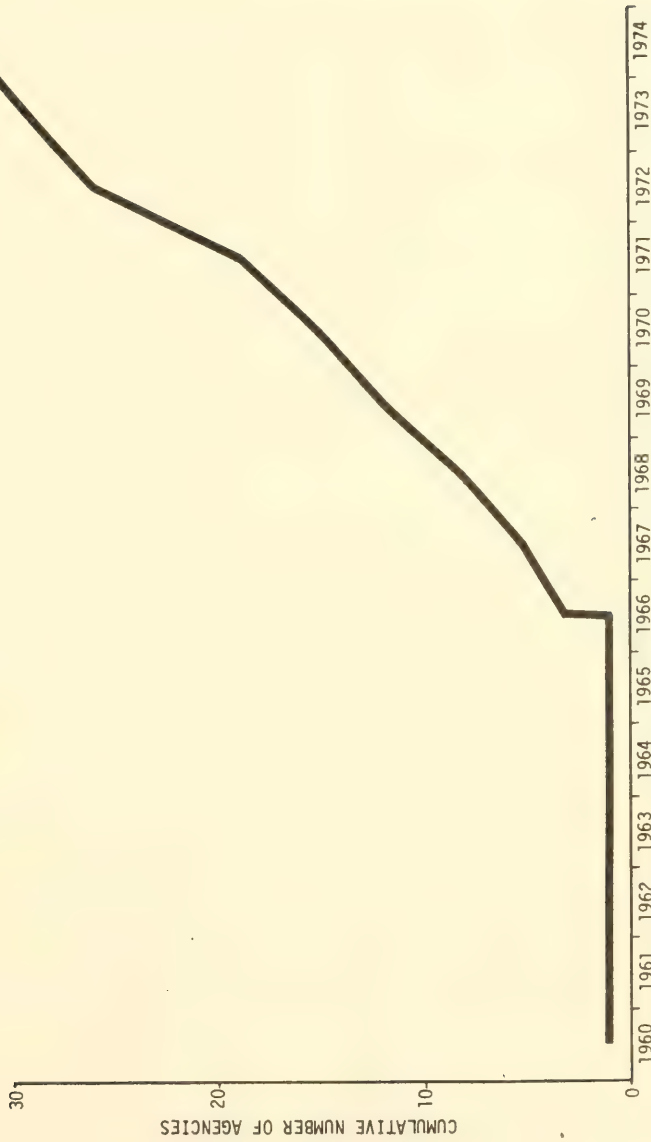
In general, State finance agencies have been given a broad range of authority in addition to financial capabilities. All but six of the finance agencies are empowered to survey and evaluate statewide housing deficiencies and develop programs to correct the deficiencies. (Table 1) Thirteen of the 30 State agencies directly administer Federal housing subsidy programs, with nearly all of the rest empowered to do so when they become fully operational.

CHART 1
STATE HOUSING AGENCIES OPERATING OR AUTHORIZED AS OF JULY 1973



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA SUPPLIED BY STATE AGENCIES.

CHART 1a
GROWTH OF STATE HOUSING FINANCE AGENCIES



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA SUPPLIED BY STATE AGENCIES.

Eighteen are authorized to acquire land by purchase or eminent domain. Apart from nine authorized to act as public housing authorities, only a few are permitted to construct or rehabilitate housing directly on their own.

Because most of the agencies are new and experiencing startup delays, only 15 of them have actually participated in the development of housing and only 11 have issued bonds or notes. Nevertheless, between January 1, 1969 and March 1, 1973, 90,587 housing units were constructed or being completed under the direction of the State agencies. Of this total more than two-thirds, or 65,994 units, were subsidized under Section 236 of the 1968 Housing Act. More than one-sixth of these, or 12,347, were eligible for rent supplement payments. Another 5,405 of the units were subsidized under other Federal programs. Only 19,188, or 21 percent, of the total units did not involve direct Federal subsidies, and a major share of these units were financed by the New York State Agency. (Table 2)

LENDING AND FINANCE ACTIVITY

The creation of State housing finance and development agencies is authorized by the State legislatures. The enabling legislation typically provides that the governor include in his annual budget the amount, if any, necessary to satisfy any deficiencies in meeting the debt service of the bonds utilized to finance projects. However, the State legislature is not legally bound to appropriate such amounts. Thus the debt issued by these agencies is said to have the "moral obligation" of the State in support of its repayment.

All but two of the State agencies are empowered to raise funds through the issuance of tax-exempt bonds. Authorized amounts range from \$20 million to an unlimited capacity. To date 11 agencies have issued bonds, with an aggregate value of approximately \$4.7 billion. The bonds are sold through private underwriters to private investors. The granting of unlimited bonding capacity is a privilege that has been given by the legislatures primarily to the agencies formed since 1971. Several of the more active agencies possess bonding capacities ranging between \$500 million and \$1.5 billion.

Because the bonds are exempt from Federal taxation, they have sold at net yields mainly between 5.3 and 7 percent. (Chart 2) Payments on the bonds are generally made from project revenues and Federal subsidies.

TABLE 2

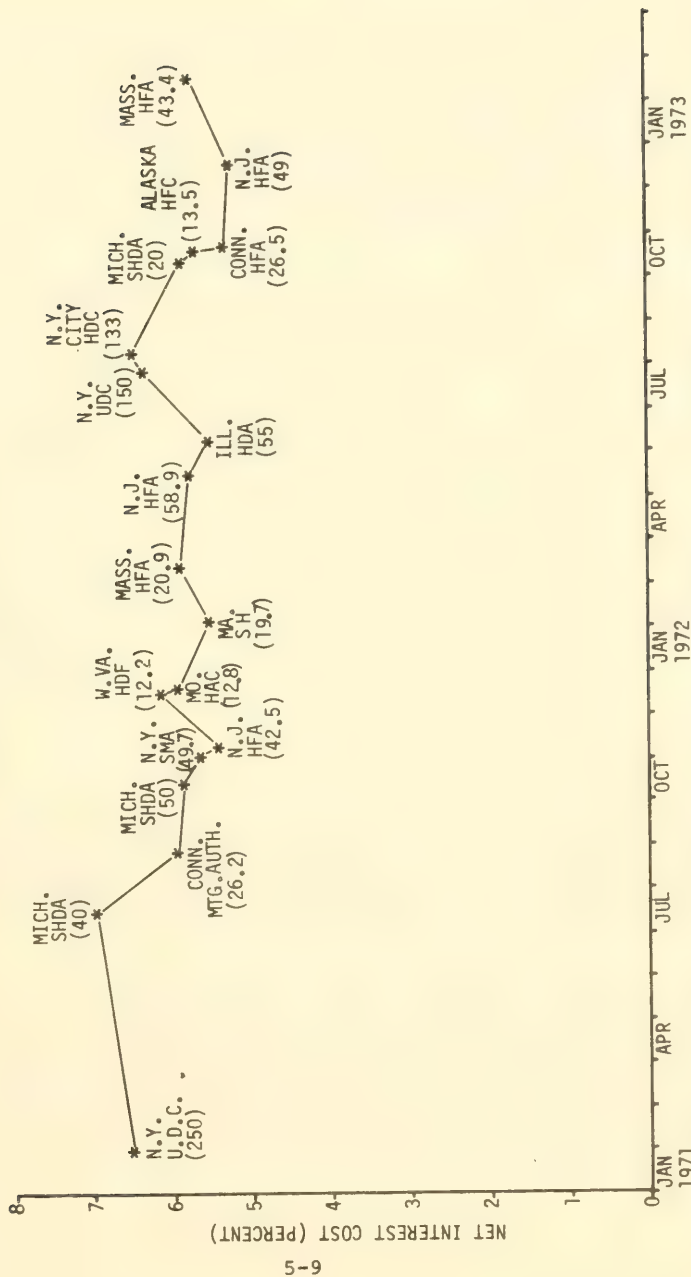
HOUSING PRODUCTION COMMITTED TO BE FINANCED BY THE STATE HFA'S

JANUARY 1, 1969 - MARCH 1, 1973

YEAR	TOTAL UNITS COMMITTED	TOTAL FEDERALLY SUBSIDIZED UNITS	SECTION 236 UNITS
1969	4,367	838	838
1970	23,866	20,858	20,196
1971	29,936	24,913	22,803
1972	30,543	22,915	20,413
1973 (TWO MONTHS)	1,875	1,875	1,744
TOTAL	90,587	71,399	65,994
JANUARY 1, 1973 PROJECTION FOR YEAR 1973	61,881	49,327	46,662

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW,
BASED ON DATA SUPPLIED BY STATE AGENCIES, EXCLUDING NEW YORK CITY AGENCIES.

CHART 2
BOND ISSUANCES AND INTEREST RATES
HOUSING FINANCE AND DEVELOPMENT AGENCIES
 JANUARY, 1971 - MARCH, 1973



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA SUPPLIED BY FIRST BOSTON CORPORATION.

* ISSUING AGENCY

() ISSUE AMOUNT, IN MILLIONS OF DOLLARS

With the funds raised through bond issues -- as well as those granted in the initial legislative appropriations -- most of the finance agencies are empowered to make "seed money" loans to nonprofit and public developers of housing. These loans are used to help offset the initial costs of such basic expenses as land clearance and preparation, as well as architectural and legal fees. The agencies are authorized to make construction loans as well as permanent mortgage loans to cover the entire project. Normally the "seed money" loans are repaid from the construction loans.

About two-thirds of the agencies have the capacity to purchase existing mortgages. Almost one-third of them are able to grant abatement of property taxes to developers of projects constructed for low- and moderate-income housing.

Although agencies' lending practices vary considerably, most finance agencies make available the advantages of their lower cost loans to developers. Because of their tax-exempt borrowing power, the agencies often pay 2 to 2.5 percentage points less for money than conventional lending institutions charge on loans (5.5 - 6 percent vs. 8 percent). The agencies pass the savings on to the developer, who is either a non-profit or limited profit sponsor entitled to a partial tax exemption. Higher loan-to-value ratios and longer mortgage terms are provided by the agencies compared to those provided by conventional lenders: 90 percent vs. 75 to 80 percent and 40 years vs. 25 to 30 years. These favorable financing terms enable the developer to set rents within the means of moderate-income families.

Only with the addition of subsidies -- such as those provided under Section 235, Section 236, rent supplements, or similar State programs -- are State housing finance agencies able to serve low-income people. In rural areas where incomes are lower, the agencies have contributed only in a limited way toward solving housing problems. The same holds as to the housing problems of the very poor in inner-city slum areas.

There are disadvantages, from the point of view of Federal fiscal policy, to tax-exempt bond financing when undertaken by either State housing finance agencies or by local housing authorities for public housing. This type of financing contains a concealed cost to the Federal Government. By not taxing the interest earned on tax-exempt housing bonds, the Government provides a subsidy through the tax system in the form of lower interest rates to the

issuing agencies. However, in the case of federally assisted projects, these tax subsidies are largely offset by the lower direct mortgage interest subsidies which HUD pays on the Section 235 and 236 loans made with bond proceeds.

The tax subsidy is inefficient because it costs the Federal Government more in forgone tax revenues than the housing finance agencies save in lower interest rates. Some 34 bond issues sold since 1961 by State housing finance agencies will cost the Federal Government \$1.62 billion in tax revenues forgone over the life of the bonds while saving the agencies \$0.60 billion in interest expense. This represents a net loss of \$1.02 billion over a 40 year period.

The inefficiency of tax-exempt bond financing for housing could be eliminated by providing a direct Federal interest subsidy to State and local agencies on taxable bonds. The net interest cost to the agency could remain roughly the same and the tax loss would be avoided.

The Administration's proposed Taxable Municipal Bond Act of 1973 probably would accomplish this objective. Under the proposed Act, taxable housing bonds would get a 30 percent interest subsidy (e.g. from 8.0 percent to 5.6 percent). The Federal cost would be offset by the increased tax revenue due to the fact that all such interest income would then be taxable.

RELATIONSHIP TO OTHER GOVERNMENT AGENCIES

Unlike most other State government agencies, housing finance and development agencies are expected to be self-supporting. On permanent loans the agency commonly charges 0.5 percentage point higher than its cost of money to fund its operating budget and loss reserves. They repay their bond holders from rental income and mortgage payments as well as with Federal subsidy funds. Except in rare circumstances, no State appropriations from general tax revenues are needed beyond the startup period of operations.

Although they are relatively autonomous by statute, the majority of the finance agencies have established relationships with other State bureaus or departments. They generally coordinate their planning activities with State departments of community affairs or State planning offices.

In the course of their production programs, State finance agencies frequently consult and coordinate with State and local social service agencies; provide housing for families dislocated by highway construction; deal with State highway and mass transit departments when considering housing placement; and work with the departments of health on housing codes and with the departments of parks and recreation to coordinate recreation facilities. However, they have had limited working relationships with State environmental protection agencies, largely because the latter are so new. They also have established ties with local communities which in some cases have asked for planning or financial assistance. They work closely with local governing bodies to obtain approval for proposed housing programs and necessary zoning variances and tax abatements.

PERFORMANCE

State housing finance agencies have concentrated the bulk of their housing activities on the development of multi-family rental developments to the virtual exclusion of homeownership projects (largely due in most States to the lack of a court test of mortgage loans to individual homeowners as a legitimate public purpose within the interpretation of each State constitution). The majority of their structures -- 72 percent -- are high rise. Most of their work has been confined to construction of new units, rather than rehabilitation of existing units, and nearly 100 percent of the new units have been built in urban and suburban areas. Thus, State housing finance agencies are open to the charge that they have failed to address the housing needs of small towns and rural areas. The housing needs of medium to large sized families are not being met through by housing finance agency assisted projects since these agencies are building the largest number of their units -- 39 percent -- with two bedrooms. (Another 32 percent are one-bedroom units and 18 percent have three bedrooms.)

In general, the inclusion of superior amenities, better design, and new technology has caused mortgage amounts per unit on housing finance agency assisted projects to exceed those federally subsidized projects undertaken without State agency participation. This forces the occupants in State-financed housing projects to pay higher rents than their counterparts in federally processed projects. The average per unit Federal subsidy for finance agency projects varies from \$734 in the Great Lakes region to \$1,448 in the

high cost areas of New York and New Jersey. (Table 3) These figures do not include taxes forgone from investors in the agency's tax-exempt bonds.

TABLE 3

PER UNIT FEDERAL SUBSIDIES OF STATE HOUSING FINANCE
AGENCY DEVELOPMENTS BY HUD REGION

Region	Average Annual Subsidy per Unit
I - Mass., Conn., Me.	\$852
II - N.Y., N.J.	\$1,448
III - W. Va.	\$937
V - Mich., Ill.	\$734

SOURCE: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by State Agencies.

The more experienced housing finance agencies have been able to deliver their projects for occupancy more rapidly than HUD. Typically housing finance agency projects are open for occupancy in from 12 to 16 months, with the average ready in about 14 months. HUD projects take on the average 34 months for completion. HUD's longer processing time is attributable to the greater number of HUD personnel involved in reviews and approvals, and the deeper HUD organizational hierarchy which forces the transmission of documents and decisions back and forth between area, regional, and central offices.¹

¹Booz, Allen and Hamilton, "Comparative Analysis of Federal and Nonfederal Government Housing Program Procedural and Managerial Implementation," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

The majority of State finance agencies operate equal opportunity programs. While statistics on the racial mix in their housing units are inconclusive, the available data indicate that the fraction of nonwhite occupants in State-financed units is in the neighborhood of 21 percent. This figure approximates that for federally assisted Section 236 projects, which currently places the minority occupancy rate at about 24 percent. In addition to efforts to recruit nonwhite tenants, State housing agency projects have directed attention towards providing housing for other special groups, such as the elderly and the handicapped, who represent 12 percent of the housing population in State projects.

Most of the agencies claim that they strive for an economic mix in each project with some tenants paying the going market rate for their units while others receive the benefits of Section 236 and rent supplement aid. In Michigan, for example, families with incomes from \$4,000 to \$14,000 have moved into the same project. A project in Massachusetts houses families with incomes from \$2,000 to \$20,000, with individual units renting at market rents, or Section 236 levels, or at public housing rentals under Section 23 leasing arrangements.

To date none of the 294 Section 236 projects financed by housing finance agencies have been foreclosed and only six of them have had any serious rent-up problems.

PROSPECTS AND PROBLEMS

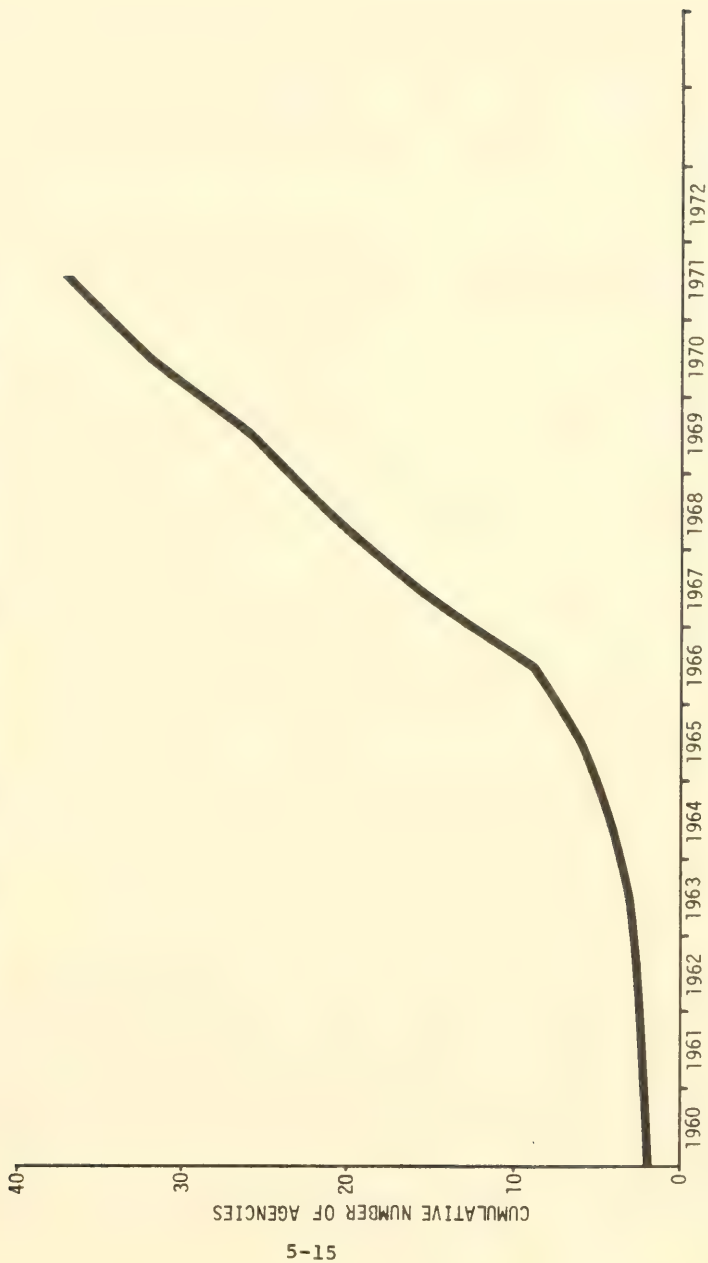
Despite the rapid growth and initial achievements of State housing finance agencies, their future expansion is not completely assured, and some serious problems eventually will have to be confronted. The major problems are the agencies' heavy emphasis on new housing construction as opposed to utilization of existing housing stock, and their heavy dependence on indirect and direct Federal subsidization -- principally through tax-exempt bond financing combined with the Section 236 housing subsidy program, two subsidies that are quite costly to the Federal Government.

COMMUNITY AFFAIRS AGENCIES

Another recent development reflecting increased State activity in the housing field has been the establishment of community affairs departments. Today there are 37 States with such offices functioning -- with all but two of them formed since 1960. (Chart 3)

CHART 3

GROWTH OF STATE COMMUNITY AFFAIRS AGENCIES, 1960-1972



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DATA FROM COUNCIL OF STATE GOVERNMENTS, THE BOOK OF THE STATES, 1973.

Although there is no single way to describe the functions of State community affairs agencies because their activities vary from State to State, they are involved in statewide planning, regional planning, local planning and urban renewal activities. Depending on their size, they may also be involved in such housing-related matters as poverty, environmental control, health, law enforcement and highway safety.

For the most part, the experience of these agencies has been limited to providing information, technical assistance, research and planning to local communities. They explain and clarify Federal activities and educate cities, towns and counties on how to obtain Federal funds.

The size of the staffs available to carry out the assorted functions of the community affairs agencies appears to depend on the degree of urbanization in the State as a whole. For example, the New Jersey Agency, which performs most of the functions listed, has a staff of 400, higher than the employment levels of all other agencies. Vermont operates its Agency of Development and Community Affairs with a staff of five. (See Table 4)

In short, it is difficult to lump all the community affairs agencies together because their functions are so diverse. For example, a majority provide financial advice and assist in municipal management. Others provide such basic State services as personnel training. Most -- operating as adjuncts of the governor's office -- work toward legislation.

Nevertheless, their existence represents a reorganization of State programs, geared to the multiplying activities of State governments in the housing and community development field in response to both Federal programs and the problems faced by local governments. (Table 5)

LAND USE CONTROLS

Until fairly recently controls over land use have rested primarily with local governments, in the form of the zoning power delegated to them by the States. But in the past five years particularly, some States have been reasserting their authority over the land within their borders, insisting that it is the State's responsibility to preserve the environment. Additionally, the inherent inadequacy of local controls in meeting regional and statewide needs has encouraged increased State activity.

TABLE 4
PROGRAM RESPONSIBILITIES OF STATE OFFICES OF COMMUNITY AFFAIRS

STATE	DATE AGENCY ESTABLISHED	SERVICE AGENCY	REPORTS DIRECTLY TO GOVERNOR	SIZE OF STAFF	STATE PLANNING (FTE)	GENERAL PLANNING (FTE)	URBAN RE-DEVELOPMENT (FTE)	POVERTY	HOUSING	HEALTH	IN-DEVELOPMENT (FTE)	ENVIRONMENTAL CONTROL	WATER SUPPLY	LAND-USE PLANNING	TECHNICAL ASSISTANCE (FTE)	COMMUNITY DEVELOPMENT TRAINING (FTE)	STATE
ALABAMA	1969	DEVELOPMENT OFFICE	*	71	*	*	*	*	*	*	*	*	*	*	*	*	ALABAMA
ALASKA	1959	LOCAL AFFAIRS AGENCY	*	15	*	*	*	*	*	*	*	*	*	*	*	*	ALASKA
ARIZONA	1968	DEPT. OF ECONOMIC PLANNING & DEVELOPMENT	*	49	*	*	*	*	*	*	*	*	*	*	*	*	ARIZONA
ARKANSAS	1971	DEPT. OF PLANNING	*	70	*	*	*	*	*	*	*	*	*	*	*	*	ARKANSAS
CALIFORNIA	1965	DEPT. OF HOUSING & COMMUNITY DEVELOPMENT	*	135	*	*	*	*	*	*	*	*	*	*	*	*	CALIFORNIA
COLORADO	1964	COUNCIL ON INTERGOVERNMENTAL RELATIONS	*	10	*	*	*	*	*	*	*	*	*	*	*	*	COLORADO
CONNECTICUT	1970	DEPT. OF LOCAL AFFAIRS	*	136	*	*	*	*	*	*	*	*	*	*	*	*	CONNECTICUT
DELAWARE	1967	DEPT. OF COMMUNITY AFFAIRS	*	230	*	*	*	*	*	*	*	*	*	*	*	*	DELAWARE
FLORIDA	1970	DEPT. OF COMMUNITY AFFAIRS	*	69	*	*	*	*	*	*	*	*	*	*	*	*	FLORIDA
GEORGIA	1970	BUREAU OF STATE PLANNING AND COMMUNITY AFFAIRS	*	100	*	*	*	*	*	*	*	*	*	*	*	*	GEORGIA
ILLINOIS	1969	DEPT. OF LOCAL GOVERNMENT AFFAIRS	*	150	*	*	*	*	*	*	*	*	*	*	*	*	ILLINOIS
IOWA	1969	DIV. OF MUNICIPAL AFFAIRS	*	11	*	*	*	*	*	*	*	*	*	*	*	*	IOWA
KENTUCKY	1968	PROGRAM DEVELOPMENT OFFICE	*	30	*	*	*	*	*	*	*	*	*	*	*	*	KENTUCKY
MARYLAND	1970	DEPT. OF ECONOMIC & COMMUNITY DEVELOPMENT	*	10	*	*	*	*	*	*	*	*	*	*	*	*	MARYLAND
MASSACHUSETTS	1968	DEPT. OF COMMUNITY AFFAIRS	*	200	*	*	*	*	*	*	*	*	*	*	*	*	MASSACHUSETTS
MINNESOTA	1967	DIV. OF LOCAL AND URBAN AFFAIRS	*	18	*	*	*	*	*	*	*	*	*	*	*	*	MINNESOTA
MISSISSIPPI	1964	COMMUNITY AND AREA DEVELOPMENT DIV.	*	26	*	*	*	*	*	*	*	*	*	*	*	*	MISSISSIPPI
MISSOURI	1967	DEPT. OF COMMUNITY AFFAIRS	*	82	*	*	*	*	*	*	*	*	*	*	*	*	MISSOURI
MONTANA	1970	COMMUNITY DEVELOPMENT DIV.	*	10	*	*	*	*	*	*	*	*	*	*	*	*	MONTANA
NEBRASKA	1967	DIV. OF COMMUNITY AFFAIRS	*	10	*	*	*	*	*	*	*	*	*	*	*	*	NEBRASKA
NEW JERSEY	1966	DEPT. OF COMMUNITY AFFAIRS	*	400	*	*	*	*	*	*	*	*	*	*	*	*	NEW JERSEY
NEW YORK	1959	OFFICE FOR LOCAL GOVERNMENT	*	209	*	*	*	*	*	*	*	*	*	*	*	*	NEW YORK
NORTH CAROLINA	1966	OFFICE OF PLANNING SERVICES	*	240	*	*	*	*	*	*	*	*	*	*	*	*	NORTH CAROLINA
NORTH DAKOTA	1971	DIV. OF LOCAL AFFAIRS	*	20	*	*	*	*	*	*	*	*	*	*	*	*	NORTH DAKOTA
OHIO	1967	STATE PLANNING DIV.	*	6	*	*	*	*	*	*	*	*	*	*	*	*	OHIO
OKLAHOMA	1967	DEPT. OF URBAN AFFAIRS	*	130	*	*	*	*	*	*	*	*	*	*	*	*	OKLAHOMA
OREGON	1969	LOCAL AFFAIRS & PLANNING	*	42	*	*	*	*	*	*	*	*	*	*	*	*	OREGON
PENNSYLVANIA	1969	LOCAL GOVERNMENT RELATIONS DIV.	*	10	*	*	*	*	*	*	*	*	*	*	*	*	PENNSYLVANIA
1966	DEPT. OF COMMUNITY AFFAIRS	*	260	*	*	*	*	*	*	*	*	*	*	*	*	*	
RHODE ISLAND	1968	DEPT. OF COMMUNITY AFFAIRS	*	80	*	*	*	*	*	*	*	*	*	*	*	*	RHODE ISLAND
TENNESSEE	1963	OFFICE OF LOCAL GOVERNMENT	*	10	*	*	*	*	*	*	*	*	*	*	*	*	TENNESSEE
TEXAS	1967	OFFICE OF URBAN AND FEDERAL AFFAIRS	*	80	*	*	*	*	*	*	*	*	*	*	*	*	TEXAS
UTAH	1971	DEPT. OF COMMUNITY AFFAIRS	*	25	*	*	*	*	*	*	*	*	*	*	*	*	UTAH
VERMONT	1971	DEPT. OF COMMUNITY AFFAIRS	*	35	*	*	*	*	*	*	*	*	*	*	*	*	VERMONT
VIRGINIA	1968	AGENCY OF DEVELOPMENT & COMMUNITY AFFAIRS	*	5	*	*	*	*	*	*	*	*	*	*	*	*	VIRGINIA
WASHINGTON	1966	DIVISION OF SYSTEMS PLANNING	*	175	*	*	*	*	*	*	*	*	*	*	*	*	WASHINGTON
WEST VIRGINIA	1967	PLANNING & COMMUNITY AFFAIRS AGENCY	*	52	*	*	*	*	*	*	*	*	*	*	*	*	WEST VIRGINIA
1969	OFFICE OF FEDERAL-STATE RELATIONS	*	73	*	*	*	*	*	*	*	*	*	*	*	*	*	
WISCONSIN	1967	DEPT. OF LOCAL AFFAIRS AND DEVELOPMENT	*	165	*	*	*	*	*	*	*	*	*	*	*	*	WISCONSIN

SOURCE: COUNCIL OF STATE GOVERNMENTS, THE BOOK OF THE STATES, 1972 - 1973

TABLE 5
FUNCTIONS OF STATE OFFICES OF COMMUNITY AFFAIRS

STATE	DATE AGENCY ESTAB- LISHED	SERVICE AGENCY	FISCAL MANAGE- MENT	WEL- FARE DEVELOP- MENT	ECONOMIC DEVELOP- MENT	ENGI- NEERING AND PUBLIC WORKS	LEGAL ADVICE ON GOVERN- MENTAL MATTERS	PERSON- NEL TRAINING	INTER- LOCAL COOPERA- TION	RECOMMEN- DATIONS & LEGIS- LATION	STATE COORDI- NATION	RESEARCH AND INFORMA- TION	BOUNDARY QUESTIONS	FINAN- CIAL ASSIS- TANCE	LOCAL FINANCE SUPER- VISION
ALABAMA	1969	DEVELOPMENT OFFICE													
ALASKA	1959	LOCAL AFFAIRS AGENCY													
ARIZONA	1968	DEPT. OF ECONOMIC PLANNING AND DEVELOPMENT													
ARKANSAS	1971	DEPT. OF PLANNING													
CALIFORNIA	1965	DEPT. OF HOUSING AND COMMUNITY DEVELOPMENT													
	1964	COUNCIL ON INTERGOVERNMENTAL RELATIONS													
COLORADO	1970	DEPT. OF LOCAL AFFAIRS													
CONNECTICUT	1967	DEPT. OF COMMUNITY AFFAIRS													
DELAWARE	1970	DEPT. OF COMMUNITY AFFAIRS & ECONOMIC DEVELOPMENT													
FLORIDA	1970	DEPT. OF COMMUNITY AFFAIRS													
GEORGIA	1970	BUREAU OF A STATE PLANNING AND COMMUNITY AFFAIRS													
ILLINOIS	1969	DEPT. OF LOCAL GOVERNMENT AFFAIRS													
INDIANA	1969	DIV. OF MUNICIPAL AFFAIRS													
KENTUCKY	1968	PROGRAM DEVELOPMENT OFFICE													
MARYLAND	1970	DEPT. OF ECONOMIC AND COMMUNITY DEVELOPMENT													
MASSACHUSETTS	1968	DEPT. OF COMMUNITY AFFAIRS													
MINNESOTA	1967	DIV. OF LOCAL AND URBAN AFFAIRS													
MISSISSIPPI	1964	COMMUNITY AND AREA DEVELOPMENT DIV.													
MISSOURI	1967	DEPT. OF COMMUNITY AFFAIRS													
MONTANA	1970	COMMUNITY DEVELOPMENT DIV.													
NEBRASKA	1967	DIV. OF COMMUNITY AFFAIRS													
NEVADA	1966	DEPT. OF COMMUNITY AFFAIRS													
NEW JERSEY	1959	OFFICE FOR LOCAL GOVERNMENT													
NEW YORK	1966	OFFICE OF PLANNING SERVICES													
NORTH CAROLINA	1971	DIV. OF LOCAL AFFAIRS													
NORTH DAKOTA	1965	STATE PLANNING DIV.													
OHIO	1967	DEPT. OF URBAN AFFAIRS													
OKLAHOMA	1971	OFFICE OF COMMUNITY AFFAIRS AND PLANNING													
OREGON	1969	LOCAL GOVERNMENT RELATIONS DIV.													
PENNSYLVANIA	1966	DEPT. OF COMMUNITY AFFAIRS													
RHODE ISLAND	1968	DEPT. OF COMMUNITY AFFAIRS													
TENNESSEE	1963	OFFICE OF LOCAL GOVERNMENT													
TEXAS	1967	OFFICE OF URBAN AND FEDERAL AFFAIRS													
UTAH	1971	DEPT. OF COMMUNITY AFFAIRS													
VERMONT	1968	AGENCY OF DEVEL.													
VIRGINIA	1966	DIV. OF A STATE PLANNING AND COMMUNITY AFFAIRS													
WASHINGTON	1965	PLANNING AND COMMUNITY AFFAIRS													
WEST VIRGINIA	1969	OFFICE OF INTERSTATE RELATIONS													
WISCONSIN	1967	DEPT. OF LOCAL AFFAIRS AND RELATIONS													

A few States have developed comprehensive plans to regulate land on a statewide basis. They are chiefly States with small land areas. A prime example is the State of Hawaii which enacted a statewide land use law in 1961 dividing its entire land area into four classifications -- agricultural, rural, urban and conservation. In Hawaii, regulations governing urban districts are administered by county governments. Regulations for rural and agricultural areas are administered by the State and the counties, while the State, through its Department of Land and Natural Resources, develops and administers regulations governing conservation districts. Another State which has reasserted land use controls is Vermont, which in 1970 adopted a comprehensive land use plan. The plan is based upon such considerations as present use and ecological suitability for further development, as well as projected population growth and optimum settlement patterns.

ENVIRONMENTAL ACTIVITY

States, anxious to preserve areas of scenic beauty or ecological sensitivity, also are beginning to protect such areas through legislation. About a score of States, chiefly those with large coastal areas and wetlands, such as Maryland, Oregon and Connecticut, and others with expanses of mountain wilderness upland areas and flood plains such as New York, Vermont and Minnesota, have moved to limit development in those critical resource areas.

Several States also have established programs to control large-scale developments, such as second home subdivisions and commercial and industrial developments. A prime example of such a program is the Maine Site Selection Law, enacted in 1970, which requires State approval of developments 20 acres or more in size and all commercial or industrial development of any size that may be a source of pollution. A State commission evaluates potential pollution sources, and permission to proceed with the development can be denied outright on environmental grounds.

Almost one-half of the States -- particularly those where metropolitan development has accelerated or where major environmental areas are under development pressure -- have adopted some form of environmental protection legislation. Most, although not all, of the laws have been enacted since passage of the Federal environmental legislation of the late 1960's and early 1970's (primarily the National Environmental Policy Act of 1969, the Clean Air Act Amendments of 1970 and the Federal Water Pollution Control Act of 1972). The legislation varies considerably among the States, ranging from broad requirements for environ-

mental impact analysis to legislation prescribing or regulating development in "critical resource areas" to diverse forms of environmental land use planning laws.

Since such State activity is so recent, it is difficult to evaluate the impact of the new State environmental laws on housing. Nevertheless, it is reasonable to expect that such State initiatives ultimately will have profound effects on housing location and costs.

In all, the States are moving toward implementation of the several Federal environmental regulatory acts, including imposition of the same type of environmental impact statements on developmental projects that are now required in certain policy areas under Federal law. Reinforcing the new State trend was a recent decision of the California Supreme Court holding that environmental impact statements required under State law must be prepared by a local government for private activities for which the local government is required to issue a permit, lease or other entitlement.² Inevitably the effect will be to impose additional restrictions and expense upon housing developers. But until now the housing equation has given little or no weight to environmental considerations. To the social goal of providing adequate housing in a nondiscriminatory manner has now been added the new social goal of protecting and preserving the environment.

ACTIONS ON LOCAL CODES

Due to the complexity and variety of conflicting housing and building codes, some State governments in recent years have begun to act to simplify the construction of housing by adopting model codes.

The National Conference of States on Building Codes and Standards was founded in 1967 for the purpose of advancing State adoption of model codes. Three model building acts have been developed by the Conference: (1) The "State-wide Building Act," which relates to all types of residential construction; (2) the "Manufactured Building Act," which focuses upon interstate reciprocity and certification; and (3) the "Mobile Home Act" which incorporates a model code and contains provisions directed toward interstate acceptance and construction control.

²Friends of Mammoth vs. Board of Supervisors of Mono County, 104 Cal. Rptr. 761, 4 ERC 1593 (1972).

A number of States have already adopted mandatory State codes for some types of housing construction. The Connecticut law of 1969, for example, applies to all towns, cities, and boroughs. It provides that municipal building officials must be certified by the State building inspector before enforcing the code locally. Several States have adopted or are considering optional model building codes. Although mandatory adoption by localities would not automatically result, a standard would exist which localities could easily follow.

The most significant strides in uniform State codes have been in the area of industrialized housing. Since the late 1960's twenty-seven States have made such codes mandatory. In California, for example, a unit which receives certification at the factory is deemed to satisfy code requirements throughout the State.

Finally, since 1970, considerable progress has been made in reforming certain outmoded construction requirements. Spray-painting is gradually becoming accepted. Site-work costs on installation of manufactured modules are being reduced through agreements providing for composite crews and other cost-saving methods.

The variety and number of housing and related activities undertaken by the 50 States are summarized by Table 6.

LOCAL GOVERNMENT ACTIVITIES IN HOUSING

LOCAL HOUSING AUTHORITIES

Over the past 36 years a close partnership has developed between the Federal Government and local housing authorities in providing low-rent public housing. The primary function of the local housing authority is to develop, own or lease, and manage public housing. Starting with the Housing Act of 1937, the Federal Government has provided a public subsidy in the form of an annual contribution covering debt payments on the local financing of public housing.

Except for statewide housing authorities in nine States, public housing authorities are local agencies. As of December 31, 1972, there were 2,883 local housing authorities, with nearly half located in the southeastern and south central sections of the Nation. The 2,883 local housing authorities administer 10,248 projects containing 1,260,235 housing units under annual contribution contracts with the Federal Government. (Chart 4)

TABLE 6

HOUSING AND RELATED ACTIVITIES OF THE FIFTY STATES

	1	2	2a	2b	3	3a	3b	4	5	6	7	8a	8b	9	10	11	12	13	13a	13b	13c	13d	14	14a	14b	14c	14d	14e
	DEPT. OF COMMUNITY AFFAIRS	HOUSING FINANCE & DEVELOPMENT AGENCY	BONDS OUTSTANDING	CONFID. R. BONDING	MSG. DEVELOP. AGENCY	ACQUIRE LAND	CONST./REHAB. MSG. ACT	STATEWIDE BUDG. ACT	MANUF. ACTU. BUDG. ACT	MOBILE HOME BUDG. ACT	OCCUPANCY ACT	LAND USE CONTROLS GEN.	LAND USE CONTROLS SPEC.	ZONING	ENVIRONMENTAL CONSERVATION IMPACT STATEMENT	REG. PLANNING AGENCY PARTICIPATION	MULTI-STATE PLANNING	DEVELOPMENT	ENVIRON. CONTROL	WATERSHED	TAX ADVANCES	RELIEF FOR ELDERLY	REGIONAL TAX INCREMENT SHARING	TAX ABATEMENT-LOW INC. MSG. (FIN. ACT)	TAX ABATEMENT FOR HOMEOWNER & RENTER	LAND VALUE TAX/IN SINGLE & GRADUATED		
ALABAMA	X			X				X	X	X					X								X					
ALASKA	X	X	X		X					X	P	P			X									X				
ARIZONA	X								X	X		P											F					
ARKANSAS	X								X	X	X										X			X				
CALIFORNIA	X	P			P			X	X	X	X	X	P		X	X		X	X	X	X	X	X	X			X	
COLORADO	X	X		X					X	X		P	P		X				X	X	X	X	X	X				
CONNECTICUT	X	X	X		X			X	X	X					X	X			X	X	X	X	X	X				
DELAWARE	X	X		X		P	P				F	X	X		X	X		X	X	X		X	X					
FLORIDA	X				X	P			X	X	X	P			X							X	X					
GEORGIA	X	X			X	P	P		X	X	X	X			X						P		X		P			
HAWAII		X	X		X	X	X		X		X		X	X	X	X						X			P			
IDAH					X						X	P			X						X	X	X					
ILLINOIS	X	X	X		X	X	P		X	X	P	X			X	X		X	X	X	X	X	X					
INDIANA					P				X	X	X	X			X	X		X	X	X	X	X	X			X		
IOWA	X				P				X	X	X	P			X				X	X	X	X	X			X		
KANSAS					P					X								X	X	X	X	X	X					
KENTUCKY	X	X		X	X	P						P			X			X	X	X	X	X	X					
LOUISIANA				X						X										X		X				X		
MAINE	X	X	X		X	P	P		X	X		X	X		X			X	X	X	X	X	X		P			
MARYLAND	X	X		X		P	P	X	X	X	P				X	X					X	X	X		X	X		
MASSACHUSETTS	X		X		X			P	X	X	X	X	X	X	X	X		X	X	X		X	X		X	X		
MICHIGAN	X	X	X		X	P	P	X	X	X	P	X	X	X	X	X				X	X	X	X		P	X		
MINNESOTA	X	X			X			X	X	X	X	X	X		X	X				X	X	X	X	X	P	X		
MISSISSIPPI	X								X		X										X	X				X		
MISSOURI	X	X	X		X	P					F	P	P		X	X		X	X	X	X	X	P					
MONTANA								X							X	X							X					
NEBRASKA	X				P					X	X	P	P								X	X						
NEVADA									X	X	F	P																
NEW HAMPSHIRE					P													X	X	X	X	X	X					
NEW JERSEY	X	X	X		X	P	P	X		X	X	P	P		X			X	X	X	X	X	X		P			
NEW MEXICO									X		X				X	X				X	X	X				X		
NEW YORK	X	X	X		X	X	X	X	X	X	X	X	P		X		X	X	X	X	X	X	X		X	X		
N. CAROLINA									X	X					X	X							X					
N. DAKOTA					P					X	P				X						X	X						
OHIO	X	X		X	X		X		X			P	P		X			X	X	X	X	X	X					
OKLAHOMA	X				P				X			P	P		X						X	X				X		
OREGON	X	X		X					X	X	P	P			X						X	X	X		X			
PENNSYLVANIA	X	X		X	X				X	X	P	P	P		X		X	X	X	X	X	X	X					
RHODE ISLAND	X	X						X	X	X	X	P						X	X	X				X	X			
S. CAROLINA		X	X	X	P	P			X			P			X									X	X			
S. DAKOTA	X	X		X	X	P	P				F				X					X	X	X	X		X	X		
TENNESSEE	X	X		X	X					X						X		X	X	X	X	X	X					
TEXAS	X				P					X	F									X	X	X	X	X				
UTAH	X				P					X					X					X	X	X	X					
VERMONT	X	X							X		F	P	X		X			X	X	X	X	X	X			X		
VIRGINIA	X	X		X	X	P		X	X	X	P	F	F		X	X			X	X	X	X	X					
WASHINGTON									X	X	X				X	X				X	X	X	X					
WEST VIRGINIA	X	X	X	X	X	P	P		X		X	X	X		X			X	X	X	X	X	X					
WISCONSIN	X	X		X	X					X	X	X	X		X	X				X	X	X	X	X				
WYOMING															X						X	X	X					
TOTALS	37	30	11	17	30	5	2	15	28	38	8	17	14	2	38	15	4	-	20	20	18	43	-	45	2	4	16	

LEGEND X = OPERATING P = PENDING F = FEASIBILITY STUDY U = UNCLEAR

DATA NOT RECALLY AVAILABLE

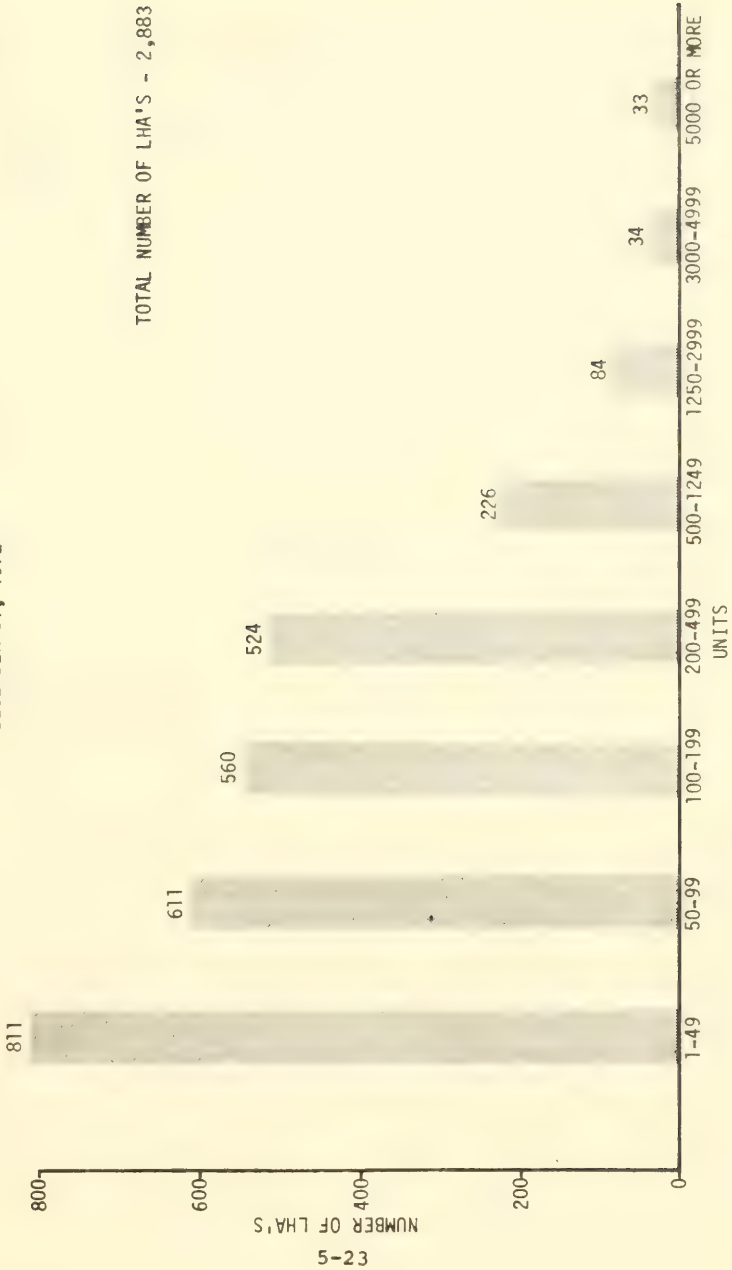
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LEGEND: X = OPERATING P = PENDING F = FEASIBILITY STUDY U = UNCLEAR

8/17/73

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW.

CHART 4
LOW-RENT PUBLIC HOUSING NUMBER OF LOCAL HOUSING AUTHORITIES
BY UNITS UNDER ANNUAL CONTRIBUTION CONTRACTS
DECEMBER 31, 1972



SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

Most local housing authorities are small; 49 percent have fewer than 100 units and only about 13 percent have 500 or more units supported under the Federal program of annual contribution contracts. Both the local and Federal costs of administering these small authorities are high. Public housing programs tend to be concentrated in the larger cities and metropolitan areas. The 140 largest authorities manage more than 60 percent of all public housing units. About 300 of the local housing authorities are located in central cities, about 450 outside central cities in metropolitan areas that fall within the category of Standard Metropolitan Statistical Areas, and the remainder outside such metropolitan areas. Some 69 percent of all places with local housing authority programs have populations of less than 10,000. Gradually the geographical jurisdictions of the housing authorities have been broadened as they sought to provide housing for low-income families. Thirty-six States permit housing authorities to extend their operations beyond city boundaries, 34 States permit county housing authorities, and 15 States have authorized regional authorities.

Local housing authorities generally are created by State enabling legislation as entities separate from the local government, with authority to sell long-term, tax-exempt bonds to finance the construction or acquisition of public housing.

The original concept was that rentals from public housing units would at least meet the operating expenses, while the local housing authority would rely upon the Federal contributions to pay off that portion of the bonds which could not be funded out of operating revenues.

In recent years many of the local housing authorities have been beset by rising operating expenses and forced to raise rents. In 1969 the Congress enacted Section 213(a) of the Housing and Urban Development Act of 1969 which limits rents charged by local housing authorities to 25 percent of the tenant's income. Recognizing that these rents were insufficient to meet operating expenses in many projects, the Congress authorized additional Federal subsidies to help pay operating expenses. Since that time, Federal operating subsidies for local public housing authorities have become a matter of serious concern to Federal housing and budget officials, as the cost of those subsidies has climbed steeply from \$31 million in Fiscal Year 1970 to \$280 million (on an annual basis) in Fiscal Year 1973. Notwithstanding the Federal infusion of operating subsidies, local housing authorities continue to experience major problems in meeting operating expenditures.

By Federal law, the maximum rent which can be charged on admission to public housing must be 20 percent below the lowest rents at which private enterprise is supplying an adequate volume of standard housing. The local housing authorities determine, subject to the approval of HUD, both the private market rent standard and the income limits for the project. Within these constraints, they set the public housing rents on the basis of the size of the unit, the tenant's income, and the operating expenses of the project. In the year ending September 30, 1972, the median income of families entering public housing was \$2,816 and the median rent was \$47 per month.

In recent years, the tenant composition of public housing has undergone a dramatic change, particularly in large and medium-sized cities. Compared to 1960, public housing tenants are much poorer. During the period from 1960 to 1972, the median income of all U.S. families rose by 90 percent, while the median income of families moving into public housing rose only 21 percent. Of the families moving into public housing in 1960, 35 percent were receiving welfare assistance and/or benefits, compared to 71 percent in 1972. The elderly population also rose sharply, from 13 percent in 1960 to 41 percent in 1972. During the same span of years, the percentage of minority population in public housing has risen to 60 percent, and the combination of poverty linked with minority group status has served to stigmatize public housing in the public's eye in many areas as a kind of undesirable "housing of last resort." Moreover, the ever-poorer status of public housing tenancy has been the single greatest contributing factor to the financial plight of local public housing authorities and, in turn, to the pressure for larger Federal operating subsidies.

There are five major factors which also have influenced the status of public housing tenancy. First, tenant incomes, while rising, lagged behind the rate of increase in operating costs brought about by inflation. Second, the problems associated with inner-city decay also tended to increase operating costs. Third, housing projects were sometimes poorly designed, and in some cases, poorly managed. Fourth, legislative changes and legal decisions prevented local housing authorities from exercising discretion with respect to tenant selection, bringing a significant increase in the proportion of problem families. Fifth, in some cases local communities failed to provide adequate community services to the tenants of public housing.

The above-mentioned legislative changes made in 1969 have directly benefited some tenants by reducing their rents. However, they have increased the amount of Federal subsidies and weakened many of the incentives for sound management of public housing at the local level. In addition, they have made it easier for some States and localities to ignore their responsibilities for effectively serving, with welfare assistance, the poor in public housing within their governmental boundaries.

Local housing authorities gradually have moved away from the role of developer to that of developer-sponsor and purchaser and also have assumed the roles of lessor and lessee. Until the mid-1960's, the local housing agencies participated in all phases of the development, construction and management of public housing. Because this procedure often resulted in delays and high costs, a number of alternative methods of development and construction have evolved. One alternative widely used since 1967 is the Turnkey Method, under which private developers enter into contracts to design and construct public housing and then turn over title to the authority once construction is completed. Local authorities have also increased their use of the Section 23 program, which was enacted in 1965. Through the Section 23 program, authorities lease housing units in existing or newly constructed, private owned buildings. (Table 7)

Selection of sites for low-rent public housing is the responsibility of local housing authorities subject to approval by HUD. In every case sites recommended by the authority must be approved by the local city council or other governing body. Because of increasing neighborhood opposition to public housing, the result of this selection process has often been to locate public housing in inner-city slum areas characterized by heavy minority concentration and inadequate public services, jobs and commercial opportunities. In an effort to reverse this trend, recent Federal court decisions have placed on the Federal Government the affirmative obligation to approve sites in such a way as to further the goal of equal housing opportunity mandated by the Civil Rights Act of 1968, but those decisions are still too recent to have had any measurable impact as yet.³

³Kennedy Park Homes Association, Inc. v. City of Lackawanna, New York, 436 Fed. 2d 108 (1970); Gautreaux v. Chicago Housing Authority, 342 Fed. Supp. 827 (1972); Shannon v. United States Department of Housing and Urban Development, 436 Fed. 2d 809 (1970); Crow v. Brown, 332 Fed. Supp. 382 (1971).

TABLE 7

LOW-RENT PUBLIC HOUSING
 NUMBER OF UNITS PLACED UNDER ANNUAL CONTRIBUTIONS CONTRACT DURING
 CALENDAR YEARS 1964-1972 BY TYPE OF PRODUCTION METHOD OR PROGRAM

TYPE OF PROGRAM	TOTAL	UNITS PLACED UNDER ACC								
		1964	1965	1966	1967	1968	1969	1970	1971	1972 *
CONVENTIONAL	202,592	32,117	21,312	26,034	36,127	10,967	21,198	32,461	10,349	12,027
TURNKEY	205,822	2,189	3,587	4,818	17,337	23,734	35,226	51,876	36,355	30,700
ACQUISITION	38,134	1,981	1,292	1,908	1,420	9,817	6,338	3,979	2,559	8,840
LEASED	153,038	412	136	10,915	14,940	31,600	41,529	16,219	8,535	28,752
TOTAL	599,586	36,699	26,327	43,675	69,824	76,118	104,291	104,535	57,798	80,319

* PRELIMINARY

NOTE: A stated method of production or type of program is subject to change during any time prior to start of construction. For example, in many instances units which were approved under the conventional program were converted to the turnkey method of production.

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

LOCAL REDEVELOPMENT AGENCIES

The activities of local redevelopment agencies are not restricted to housing development alone. Since the 1949 Housing Act, which inaugurated the urban renewal program, local redevelopment agencies have been charged with renewing areas within cities and towns and with preventing further decay in deteriorating neighborhoods.

Local urban renewal agencies generally take on responsibility for planning, site acquisition and clearance, relocation of persons displaced, installation of streets and utilities, assisting the rehabilitation of structures, and disposition of land for redevelopment. Their plans often include such public facilities as parks, schools, police and fire stations and parking lots. Cleared areas are redeveloped by private developers for residential, commercial or industrial uses, and by governmental authorities for public facilities and uses, including in many cases public housing.

As of June 30, 1972, there were 2,825 federally funded renewal projects in 1,151 localities. Between 1967 and 1972 the number of localities increased by about 29 percent and the number of projects by about 45 percent. (Table 8)

Urban renewal agencies in some States are part of city government, but in most they are separate public authorities. An urban renewal agency is responsible for the preparation and execution of a plan for the total improvement and reuse of a specific area that has been designated as a slum or "blighted" area. Their plans, which must be approved by the local general purpose government, may call for clearance and redevelopment, for rehabilitation, or for both. Redevelopment is generally executed by private developers. With the assistance of Federal subsidies, urban renewal agencies are able to "write down" the resale price of the land as a major inducement for such developers. The agencies have the power of eminent domain, which enables them to acquire and assemble land of appropriate size for development. Rehabilitation on the other hand, is generally carried out by homeowners and other property owners, with Federal loans and grants plus help and technical assistance from the renewal agency.

Control over the reuse of the land is achieved in a number of ways. Urban renewal plan requirements, which are in addition to local zoning, are usually imposed through covenants and conditions contained in purchase contracts and deeds. In rehabilitation projects, after properties are brought up to plan standards, reliance for maintenance of the renewed area is placed on local code enforcement. The agency reviews the

TABLE 8

URBAN RENEWAL PROGRAM, TOTAL APPROVALS CUMULATIVE AS OF
JUNE 30, 1967 AND 1972

DATE	NO. OF LOCALITIES	NO. OF PROJECTS	GRANT AMOUNT
1967	891	1,952	\$6.025 BILLION
1972	1,151	2,825	\$10.790 BILLION

design and construction or rehabilitation of structures. It prohibits redevelopers from transferring property at a profit before they complete construction.

Localities must supplement Federal grants by providing one-third (in some cases one-fourth) of project costs. The local share of costs may be met by contributing cash or by providing public improvements or facilities benefiting the area. In a few States, the increased tax revenues from renewal areas may be specifically allocated to repayment of debts incurred to finance renewal costs.

Redevelopment agencies have shown increasing interest in the inclusion of low- and moderate-income housing in urban renewal projects, partly because of congressional requirements laid down in 1966, 1968, and 1969. In the 1950's and early 1960's, the emphasis of the Federal statute was on the elimination of slums, rather than on the new uses of cleared land. The result was a substantial diminution of housing stock available for low-income families. In-town slums were often replaced by the "highest and best use" of the land, which often meant commercial or industrial facilities, or housing which the former residents could not afford. Since the mid-1960's, however, there has been a substantial increase in the amount of low- and moderate-income housing planned for renewal areas.

During the four fiscal years ending June 30, 1972, a total of 88,607 units of new low- and moderate-income housing was started on renewal land, compared with 72,733 total starts during the entire preceding 17 years. (Table 9)

In recent years, and again under congressional pressure as well as facilitating legislative amendments, urban renewal agencies have also placed steadily increasing emphasis upon the preservation and rehabilitation of existing housing. The number of residential buildings in renewal areas scheduled for rehabilitation increased by almost 75 percent between December 31, 1970, and June 30, 1972. (Table 10)

As of June 30, 1972, more than one million persons had been displaced from renewal projects and relocated elsewhere. Under the Uniform Relocation Assistance and Real Property Acquisition Act of 1970, as well as previous urban renewal legislation, benefits must be paid to those displaced to aid them in moving and in acquiring or renting substitute housing. Many agencies, however, have expanded their relocation activities beyond the provision of shelter and have undertaken various other services such as counseling, training and referral to appropriate social service agencies. Renewal agencies

TABLE 9

NEW HOUSING UNITS STARTED ON RENEWAL LAND
FOR PERIODS ENDING IN FISCAL YEARS 1968 AND 1972

	TOTAL	LOW-MODERATE INCOME	LOW-MODERATE INCOME AS PERCENT OF TOTAL
CUMULATIVE THROUGH JUNE 30, 1972 (ESTIMATE)	283,349	161,340	56.9%
CUMULATIVE THROUGH JUNE 30, 1968	151,796	72,733	47.9%
FOUR YEARS ENDED JUNE 30, 1972 (ESTIMATE)	131,553	88,607	67.4%

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

TABLE 10

**REHABILITATION STATUS FOR URBAN RENEWAL PROJECTS
IN EXECUTION AND NEIGHBORHOOD DEVELOPMENT PROGRAMS**
CUMULATIVE 1967-1972

STATUS	JUNE 30		DECEMBER 31			
	1972	1971	1970	1969	1968	1967
RESIDENTIAL STRUCTURES						
WORKLOAD	228,492	149,572	130,938	110,184	98,050	87,475
IN PROCESS	13,145	11,095	9,690	10,877	10,735	11,637
COMPLETED	83,798	70,708	65,094	54,275	45,737	38,825

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

are legally responsible for relocating displaced individuals and families to decent, safe, and sanitary housing, appropriate to their needs and at rents they can afford to pay.

Since 1971, the Administration has asked Congress to terminate the Urban Renewal Program as a separate categorical grant-in-aid program and in lieu of it authorize a broad urban community development program putting local general purpose governments in charge of urban development activities. Entitled the "Better Communities Act," the proposed reform is a key piece in the Administration's plans for a "New Federalism" that will strengthen the powers of State and local general purpose governments. Under this proposal HUD would allocate \$2.3 billion in Fiscal Year 1975 to cities, urban counties and States to spend on their own locally-determined, high-priority developmental needs.

LAND USE CONTROLS

The most common form of local land use control is zoning. Zoning is primarily a regulatory device, limiting the possible uses of land without directing what the actual use will be. It has emerged as an exception to the traditional concept of private ownership, which permits use of one's land free from governmental control or interference. Until the introduction of zoning in the early 20th century, regulation of land use consisted largely of the doctrines of "nuisance" and "trespass," which inhibited one's use of his land only where it interfered quite directly with the use of another's.

Modern zoning ordinances seek to segregate conflicting land uses by establishing districts or zones and separating residential, commercial and industrial uses. Within these general categories, uses may be further defined. Multi-family residences typically will be located apart from single-family homes. Two or four family structures may be separated from highrise or larger developments. Industrial and commercial zones are redivided into "light" and "heavy" uses to separate retail sales from warehouses and warehouses from factories.

Within each district, regulations may also be placed on building height, bulk, portion of land occupied and population density. Regulations controlling the size of structures often prescribe maximum or minimum floor area. Controls on population density are often accomplished by specifying minimum lot sizes.

Subdivision regulations are another land use control mechanism. While zoning has focused upon the regulation of individual lots, subdivision regulations are directed at regulating large undeveloped areas, often at the fringes of urbanization. Subdivision regulations vary from State to State, but generally come into play where there is a division of a single parcel into five or more lots. They may require a developer to furnish certain public improvements or to coordinate his plans with the municipality's master plan.

EXCLUSIONARY USE OF ZONING: Today local communities are increasingly concerned with the effects of piecemeal land development, poor planning and unrestricted growth. As a result many of them are postponing large-scale and multi-family developments until they evaluate the impact of such building activity on already strained municipal services. Some local communities also are hesitant about new building activity because of the additional expenditures that would be incurred for added municipal facilities, particularly schools. They maintain that the new growth would require additional tax levies, add to congestion and have adverse environmental effects.

The reluctance of municipalities to encourage development is manifest in their refusal to grant zoning changes or variances necessary to proceed with construction -- especially of multi-family housing, and particularly subsidized housing. Among other actions being taken by the cities and towns, particularly in the suburbs, to discourage further growth are: setting large lot zoning requirements, prescribing minimum floor space, and imposing requirements of extensive offsite improvements in subdivisions. Such practices tend to reduce the amount of land available for building and to increase the cost of individual lots and public improvements and, as a result, the cost of the dwellings themselves.

Perhaps of greater importance with respect to lower-income individuals who often reside in apartment buildings is the outright exclusion by many jurisdictions of multi-family developments. Some jurisdictions impose exorbitantly high permit fees or require substantial donation of land for public use as a precondition to granting building permits. These restrictions tend to increase the price of the housing provided.

Some localities are limiting growth by establishing an artificial geographic line, such as an "urban limit line," which prohibits development beyond that line. In some

communities, land beyond the "line" is zoned agricultural. As long as the zoning is not so restrictive as to constitute a "taking of property," which would entitle the owner to compensation, development can be prevented without cost to the municipality. The effect on housing is to reduce the amount of land available for development and consequently to raise its price.

In recent court cases challenging such zoning practices, judges have been reluctant to impose their planning judgment as a substitute for that of local officials, except in cases of racially motivated policies. Various courts have upheld minimum lot size requirements, minimum floor size specifications and certain restrictions on multifamily housing. But a few recent decisions, notably in Pennsylvania⁴ and New Jersey,⁵ have called for the municipalities to accept a "fair share" of regional growth by permitting the construction of more housing. In the National Land Investment case, the Supreme Court of Pennsylvania struck down a four-acre minimum zoning requirement, reasoning that:

Zoning is a tool in the hands of governmental bodies which must not and cannot be used by those officials as an instrument by which they may shirk their responsibilities. Zoning is a means by which a governmental body can plan for the future....Zoning provisions may not be usedto avoid the increased responsibilities and economic burdens which time and natural growth invariably bring."

BUILDING AND SEWER MORATORIA: Building and sewer moratoria, in use in a limited but growing number of municipalities, are usually implemented by a refusal to grant building permits or construct public facilities necessary for the development of housing. These moratoria reflect how cities and towns are becoming increasingly aware of the hazards and disadvantages of uncontrolled growth and its cost in the form of lost open space and congestion as well as higher tax rates caused by the need for additional public services.

⁴National Land Investment Co. v. Easttown Board of Adjustment, 419 Pa. 504, 215A.2d 597 (1965) and Appeal of Girsh, 437 Pa. 237, 263A.2d 395 (1970).

⁵Molino v. Mayor and Council of Gladsboro, 116 N.J. Super. 195, 281A.2d 401 (1971) and Oakwood at Madison, Inc. v. Township of Madison, New Jersey 117 N.J. Super. 11, 283A.2d 353 (1971).

But by failing to provide water and sewer connections, some local governments have brought residential construction to a virtual standstill in their jurisdictions, and shifted new housing locations to other areas. In areas where housing demand is strong, as it frequently is in areas where moratoria are imposed, the consequence of such action is to rapidly drive up the price of both new and existing housing. New homes may be put beyond the reach of a substantial majority of families. The price impact of moratoria is certainly undesirable. However, many local officials and their constituents consider the construction of utility networks to be a useful and legitimate tool for guiding growth, particularly in view of the ineffectiveness of other public tools to influence private decisions.

An example is Fairfax County, Virginia, a largely suburban community near Washington, D.C., where population leapt 83 percent from 1960 to 1970 (248,897 to 455,032) and where the median price of owner-occupied homes jumped almost 90 percent from 1960 to 1970 (\$18,700 to \$35,400). To meet increasing costs, the county raised from 1962 to 1972 its property tax rate 28 percent -- from \$3.35 to \$4.30 per \$100 of assessed valuation.⁶ To combat further increases in tax rates and losses of open spaces, the county in 1972 imposed a sewer moratorium, which in effect has stopped large-scale development and triggered considerable litigation brought against the county government by large and small-scale developers.⁷

ENVIRONMENTAL ACTIVITIES

Localities also are showing a rapidly accelerating concern for environmental preservation and are increasingly evaluating proposed housing developments from this standpoint. As in the case of State actions in the environmental area, many of the local efforts are in response to the Federal environmental regulatory acts concerning the quality of air and clean water, for example.

⁶However, from 1961 to 1971 the assessment-to-sales price ratio for single-family houses in Fairfax County fell from 33.3 percent to 31.5 percent. This reduced the effective tax rate increase to about 21.4 percent.

⁷See, for example, Gulf-Reston v. Fairfax Co. Board of Supervisors, Sixteenth U.S. Circuit Court (1973).

Since 1970 almost 400 communities have adopted or are considering the adoption of environmental goals or policies. In a recently completed survey of local governments which drew more than 1,100 responses, 43 percent were found to have an environmental policy in operation or under consideration.⁸ Almost one-fourth of the responding large cities with populations in excess of 250,000 announced they had established environmental departments, departmental units, or agencies to provide advice, and carry out inspections, monitoring and planning functions. Before any proposed public or private development is authorized in 30 percent of those communities that have environmental policies in force, the builder or developer is required to file an environmental impact statement that shows what effect the proposed development will have on the environment.

Many of the locally required impact statements are patterned after the requirement in the National Environmental Protection Act of 1969, though there are some significant variations.

BUILDING CODES

Building codes are imposed by a municipality to establish minimum safeguards in building construction and to protect occupants from such hazards as fire and collapse.

They deal with the shell and internal systems of the structure. Generally, their specifications are directed at structural and foundation loads and stresses, construction materials, fireproofing, building heights, ventilation, heating, plumbing and electrical systems, elevator and escalator construction and other safety devices.

Their use is most common in larger towns and cities. A survey in 1968⁹ revealed that of the almost 18,000 local governments sampled, only 46.4 percent had building codes. On the other hand, of approximately 4,000 cities and towns with a population of 5,000 or above, more than 80 percent had building codes.

⁸Data collected in an analysis for the Environmental Protection Agency under a grant administered by the International City Managers Association (1973).

⁹Allen D. Manvel, Local Land and Building Regulation, prepared for the National Commission on Urban Problems, 1968.

The multiplicity of codes is frequently criticized for lack of uniformity, outdated provisions and inconsistency. Such multiplicity has been condemned, particularly by builders, who frequently cite it as contributing substantially to higher construction costs by preventing economies of scale and discouraging innovations.

The variety of building components covered by the codes makes efforts at uniformity a major task. In some jurisdictions building codes encompass electrical, plumbing and mechanical codes, while in other municipalities such codes are separate. There is also considerable diversity in the administration of codes, resulting in different interpretations of similar codes in different jurisdictions.

There are signs that the problem of diverse and conflicting building codes is abating somewhat through joint State and local action. Four national model codes¹⁰ and many State model codes have been formulated to cut through the maze. In a 1968 survey of municipalities, approximately two-thirds of those responding reported that they had based their codes originally on one of the model codes. Only about 15 percent, however, had regularly reviewed recommended changes so that their codes were reasonably up-to-date.

The guidelines for the new State models were laid down by the National Conference of States on Building Codes and Standards, discussed earlier.

HOUSING CODES

Unlike building codes, which are directed at the structural aspects of buildings, housing codes are concerned with conditions of occupancy. The primary areas covered by typical local housing codes are: (1) minimum facilities: toilet, bath, heat, water, light and ventilation; (2) level of maintenance; and (3) standards of occupancy such as size and number of rooms as related to the number of people who may occupy them.

Housing codes are the outgrowth of concern about the existence of unsanitary conditions in old housing and poor construction in new housing. Prior to the 1964 amendment to

¹⁰American Public Health Association Code, International Conference of Building Officials Code, Building Officials Conference of American Code and Southern Standard Housing Code.

the National Housing Act of 1954, which required that housing codes be included in the Workable Program for urban renewal grants, few jurisdictions had adopted codes. A study by the Housing and Home Finance Agency (HUD's predecessor) revealed that in 1956 fewer than 100 of the larger cities had housing codes.¹¹ By 1968, a survey of 17,993 local governments of all sizes showed that 4,904 had housing codes.¹²

In 1968, the National Commission on Urban Problems found that even in jurisdictions where housing codes existed, the standards they established often were inadequate to provide even minimum conditions of health and safety. There was no uniform set of criteria for determining what constituted "standard" or "substandard" conditions. Moreover, although many jurisdictions professed to have adopted one of the four national model codes, local variations were often made which in some cases eliminated or reduced the minimum standards of the model code.

A second criticism of housing codes concerns the way in which they are enforced. Building officials become aware of code violations in two ways: complaints by residents and systematic inspection. The first way is haphazard and unreliable, and the second very costly. As a result violations often go unnoticed and uncorrected.

RENT CONTROLS

Alarmed at the rapid rate of rent increases in recent years, a growing number of city and county governing bodies are considering and passing rent control ordinances. These ordinances either limit or prohibit landlords from increasing tenant's rents.

Although rent controls apply a quick and popular brake on inflationary housing costs, they can bring unwanted consequences if retained over a long period of time. Apartment owners are faced with rising expenses, too -- for property taxes, maintenance and repairs, trash removal, and other municipal services. Expenses which cannot be passed on to tenants must be absorbed by the owner and eventually will

¹¹Urban Renewal Administration, Housing and Home Finance Agency, "Provisions of Housing Codes in Various American Cities," Urban Renewal Bulletin No. 3, 1956.

¹² Allen D. Manvel, op. cit.

reduce his profit and return on investment. To compensate, owners often cut back on maintenance services or postpone planned improvements. If rent controls persist, the property may become run-down, and the owner may be forced to either sell or abandon it.

The experience in New York City, which has had rent control intermittently since 1916 and continuously since 1943, illustrates how this unfortunate chain reaction can occur. In that city, it appears that rent control has contributed to undermaintenance, deterioration, and abandonment of rental housing. Owners often "milk" whatever profit they can out of their buildings and make more advantageous investments.¹³

Financial institutions, too, have been reluctant to invest equity capital or make loans on properties subject to New York's rent controls. This reluctance has further punished the existing housing stock and retarded the construction of new apartments.

Finally, the administration of rent control becomes more burdensome and complex over time. For example, New York first tried to prohibit any exceptions to rent control, then instituted an increasingly complicated formula for justifying increases, and recently "decontrolled" certain categories of rental housing.¹⁴

In short, rent controls may keep rents down for consumers for a period of time, but only at the long term danger of losses to owners, disinvestment and deterioration in existing rental housing, administrative problems and eventually an inadequate supply of new rental housing.

PUBLIC SERVICES AND TAX POLICY

The location and density of housing have a significant impact on the level of expenditures of local governments. The municipalities must provide public utilities and police

¹³George Sternlieb, The Urban Housing Dilemma; The Dynamics of New York City's Rent Controlled Housing, New York Housing and Development Administration, Department of Rent and Housing Maintenance, Office of Rent Control, 1972.

¹⁴*Ibid.*

and fire protection as well as other services and facilities. They have become increasingly opposed to authorizing large new developments because of the added strain that would be imposed on their resources.

The Nation's cities and towns rely heavily on the property tax to finance public services; as their costs soared over the last decade, they have become more reliant on State governments and the Federal Government to help them meet expenses.

In Fiscal Year 1971, almost 31 percent of local revenues were provided by the State, (including Federal "pass-through" payments which are matched by State funds) while Federal direct payments amounted to 3.4 percent of all revenue. (Table 11)

It is too early to predict the extent to which Federal revenue sharing will alter the revenue structure of State and local governments. The Federal payments are expected to help relieve the squeeze between increasing demands for services and intensifying taxpayer protests. Through mid-summer 1973, \$8.131 billion in general revenue sharing funds had been distributed to more than 38,000 State and local government units.

The fiscal strain on most States has lightened recently, due in some part to the infusion of Federal revenue sharing dollars. According to a survey in 1971, proposals to increase existing State taxes or create new taxes were expected to be considered by 35 of the 49 State legislatures meeting that year. A subsequent survey revealed that by the end of 1972, States had surpluses of \$12.3 billion -- due primarily to the economic upturn of 1972, lower school populations and revenue sharing -- and only a few States were considering tax increases for 1973.

LOCAL TAX POLICIES

Because of their heavy reliance on property and sales taxes, local communities often encourage the development of high tax-producing commercial and industrial facilities rather than low-yielding residential structures. It is commonly believed that the costs of providing public services to residential structures (particularly those designed for low- and moderate-income families) exceed the tax revenues they produce.

TABLE 11

STATE AND LOCAL GOVERNMENT REVENUE, 1966-1971

(AMOUNTS IN MILLIONS OF DOLLARS)

	STATE GOVERNMENT			LOCAL GOVERNMENT				
	1966-1967	1970-1971	CHANGE 1967-71	1966-1967	1970-1971	CHANGE 1967-71		
	AMOUNT	AMOUNT		AMOUNT	AMOUNT			
TOTAL REVENUE	61,082	97,233	100.0	59.2	65,377	100.0	100.0	54.5
INTERGOVERNMENTAL REVENUE	14,298	23,908	24.5	66.6	20,386	31.2	34,473	69.0
FROM FEDERAL GOVERNMENT	13,616	22,754	23.4	67.1	1,889	2.9	3,391	79.5
FROM STATE GOVERNMENTS	-	-	-	-	18,507	28.3	31,081	67.9
FROM LOCAL GOVERNMENTS	673	1,154	1.1	56.6	-	-	-	-
REVENUE FROM OWN SOURCES	46,793	73,424	75.5	56.9	44,981	68.8	66,521	47.9
TAXES	31,926	51,541	53.0	61.4	29,315	44.8	43,434	48.2
PROPERTY	862	1,126	1.2	30.6	25,418	38.9	36,726	44.5
INDIVIDUAL INCOME	4,909	10,153	10.4	106.8	996	1.4	1,747	88.7
CORPORATION INCOME	2,227	3,424	3.5	53.8	-	-	-	-
SALES AND GROSS RECEIPTS	18,575	29,570	30.4	59.2	1,979	3.0	3,662	85.0
OTHER TAXES	5,354	7,268	7.5	35.8	992	1.5	1,298	30.9
OTHER REVENUE	14,867	21,883	22.5	47.2	15,667	2.0	23,088	47.4

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, GOVERNMENTAL FINANCES, 1966 - 1971.

The property tax has been criticized as having the greatest impact on housing. It is essentially a local action, although also levied by a few States. One source of criticism is the wide variation of the property tax among jurisdictions, with even some variation among neighborhoods within a single jurisdiction. The property tax also has been criticized on the grounds that it is regressive. Because housing is such a significant item in the budgets of poor families, even a property tax at a uniform rate may absorb a much higher fraction of the income of the poor than of the rich. Sharply rising property taxes over the past few years have created a special problem for the elderly, many of whom live on fixed incomes. Finally, the property tax has been criticized on the grounds that it is a tax on the consumption of a commodity which is especially valuable to the community -- residential housing. As a consumption tax, it has an effective rate greatly in excess of the rates applicable to other consumer expenditures. By increasing the cost of housing, particularly for those least able to pay, the property tax is alleged to reduce the demand for housing, or alternatively, to reduce the rate of return to housing investors. As a result, high property taxes are thought to deter increases in the stock of housing and improvements in the quality of existing housing.

Many communities are using various devices in order to overcome some of the objections to the property tax system and to encourage particular types of development.

TAX INCREMENT: Tax increment financing is used most extensively in California and Minnesota. In those States, any increases in property taxes attributable to redevelopment of a particular area is specifically allocated to finance various public costs -- such as access roads, sewers or public buildings -- of the redevelopment project. The pre-redevelopment tax revenue base continues to go to the local government's general fund. In most cases municipal bonds are issued to finance the public redevelopment costs, with the projected tax "increment" pledged to fully repay the bondholders. Most of the land developed in this way has been devoted to commercial, industrial or middle-income housing uses. Recently, however, redevelopment agencies have begun to use the increment from high tax-generating commercial and industrial development to finance improvements in low tax-generating residential areas. Although the tax increment device has proven to be very effective in rapidly growing communities, its use is more limited in small cities where growth is static.

TAXATION OF LAND VALUE: It is commonly argued that by imposing a property tax solely upon land, or at a higher rate on land than on buildings, more intensive uses of land would be encouraged. Where a sufficient level of demand exists, investors could increase their rate of return by developing sites more intensively.

Several communities already have tried various forms of land value taxation. Fairhope, Alabama has established a Single Tax Corporation which buys land and leases it to individuals and businesses for 99 years. The Corporation has simulated the effect of a site value tax by basing the rentals of its large holdings upon land alone without considering the value of any improvements.

A "graded" or "differential" tax -- where both land and improvements are taxed, but the land is taxed at a higher rate -- is currently being used in Pittsburgh, Pennsylvania, and the State of Hawaii. In two communities, Arlington County, Virginia, and Southfield, Michigan, an emphasis is placed upon land values by reassessing land annually and by basing the land assessment on potential market value rather than present use.

TAX EXEMPTIONS OR ABATEMENTS: Typically, property owned by Federal, State or municipal government entities (including public housing owned by local authorities and land and improvements owned by local redevelopment agencies) has been fully or partially exempted from local property taxation, thus increasing the level of taxes needed from other local property owners.

Tax exemptions and abatements, however, have also been used to stimulate certain types of development. Some States attempt to encourage the construction of low- and moderate-income housing owned by private developers by abating the taxes that would otherwise be imposed upon those structures.

The effect of the abatement is to reduce the operating cost of the development and thereby reduce rents which must be paid by low-income tenants. The lower rents enable developers to build and successfully market housing units that would otherwise be infeasible and remain unbuilt.

"CIRCUIT BREAKERS": In recognition of the special financial problems created for the elderly by rising local property tax rates, States are drafting and in some cases have already adopted property tax relief programs for the elderly. The programs, called "circuit breakers," vary from State to State.

Essentially they are analogous to the Administration's proposed refundable tax credit for the elderly. The proposed legislation would permit the elderly to claim a credit for the amount of property taxes they pay in excess of 5 percent of their income, limiting the credit to \$500. The legislation applies to elderly renters as well as homeowners. The credit due to renters is subject to the same 5 percent floor and \$500 maximum; for this purpose, 15 percent of their gross annual rent is assumed to be paid by landlords for property taxes.

Among the States that have already approved similar tax relief programs for the elderly are Vermont, Michigan, Wisconsin and Tennessee. All of these State programs reimburse a portion of the elderly's property tax, or pay the local government directly on behalf of the elderly.

Many of these programs represent a significant change in public policy toward housing consumers in that they are available to renters -- not just homeowners -- and they are refundable to families which pay little or no taxes.

CHAPTER 6

HOUSING CONSUMPTION

Since the end of World War II, the growth in the real income of the Nation has permitted the average American household to upgrade dramatically the quality of its housing. Yet, in the face of this improvement those at the lower end of the income scale still face housing problems, the severity of which is closely related to the severity of their poverty.

The choice of housing is highly complex, in that it involves many factors other than shelter alone. Incorporated into the housing decision are neighborhood characteristics which may be given greater weight than the size and style of the structure itself. Such characteristics as the quality of local schools, the adequacy of police and fire protection, the amount of pollution and the incidence of crime -- and many other factors -- play an important role in influencing the consumer's selection of housing.

Frequently, a home buyer or renter is unable to find the exact neighborhood he prefers and his final choice often represents a complicated trade-off between an area's good and bad characteristics. For example, a potential home buyer or renter might be willing to sacrifice proximity to his or her job in order to escape undesirable aspects of central city living, such as higher crime rates. The choice of a neighborhood is further constrained by budget considerations. Often the very poor are restricted to housing which has been partially driven down in price because of the undesirable characteristics of the neighborhood in which it is located.

As with the choice of neighborhood, the selection of the house or apartment itself is a highly complicated process in which the consumer's preferences for space, the number and arrangement of rooms, the presence or absence of amenities such as central heating, air conditioning and a host of other factors are often traded off against each other.

A study conducted for the Department of Housing and Urban Development suggests that the more affluent home buyer is often more concerned with neighborhood characteristics than with the structure of the house since he can

afford to alter the structure to suit him. In contrast, the buyer of modest income has problem enough accumulating a down-payment and the characteristics of the structure often are more important to him than the characteristics of the neighborhood.¹

In addition to structure and neighborhood considerations, the choice of housing is also constrained by the variables which determine the supply of housing, and the final choice is the result of the interaction between the forces determining supply and demand. These are dynamic forces which are not yet well understood. Therefore, this chapter does not attempt a complete description of all of the processes which determine the quantity and quality of housing consumption. Rather it emphasizes a series of snapshots of the occupied housing of different groups at different points of time.

¹Arthur D. Little, Inc., "Consumer Preferences in Housing," a study prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

THE TOTAL HOUSING STOCK

In 1970, there were over 68 million housing units in the United States, 63 million of which were occupied by households. Of the 63 million households², 37.1 percent were renters and 62.9 percent were owners.

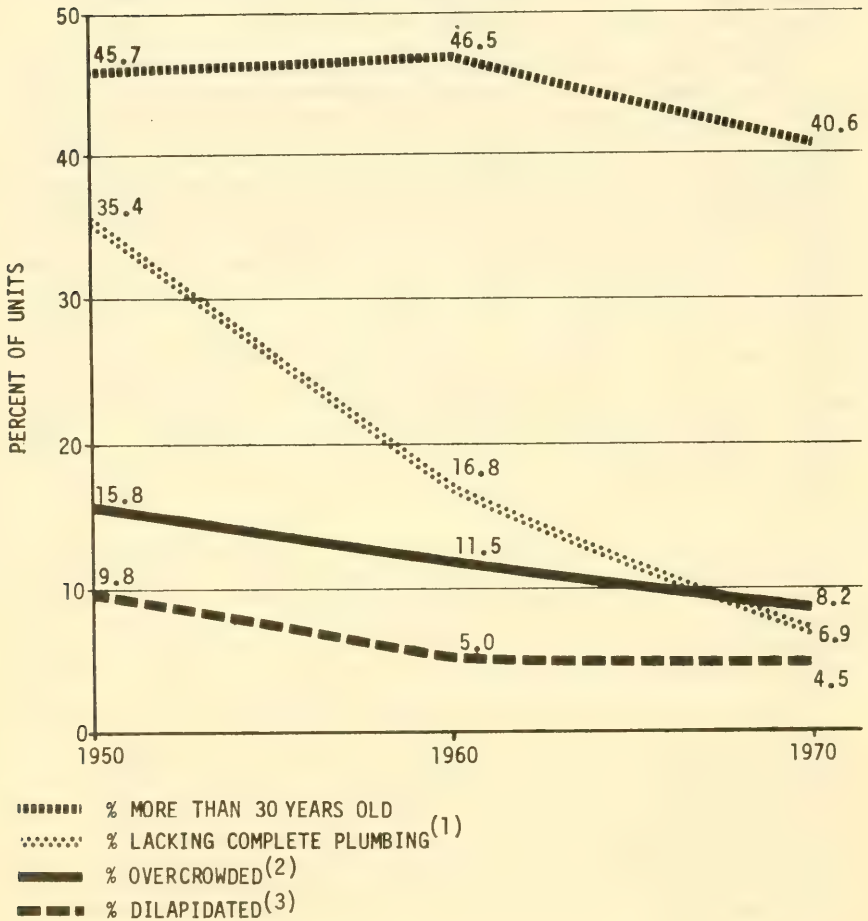
The condition of the Nation's housing stock was improved dramatically in the two decades between 1950 and 1970. Chart 1 shows that in this span the proportion of the Nation's housing stock that was dilapidated fell more than 50 percent; the proportion not having complete plumbing facilities fell over 80 percent; and the proportion that was overcrowded fell almost 50 percent. Significant differences exist in the kind and quality of housing in the various regions of the United States. The Northeast region of the country contains the highest concentration of units in 5- or more-unit structures -- 22.4 percent -- and the highest proportion of dwellings over 30 years old in 1970 -- 55.2 percent. The South has the largest proportion of single-family homes -- 77.7 percent -- and the highest percentage of housing units which lack complete plumbing facilities -- 11.9 percent. The Western region contains the lowest proportion of housing units lacking some or all plumbing -- 3.3 percent -- and has the newest housing stock with only 26.8 percent of the units over 30 years old. (Table 1)

Over time, the average size of the American household has declined, or in other words the number of households has grown much faster than the population. More specifically, between 1950 and 1970 the number of households grew 47 percent from 43 million to 63 million while the population grew only 34 percent from 151 million to 203 million. (Chart 2)

Part of the decline in household size is attributable to falling birth rates. However, growing incomes also played a role in reducing household size. As living standards improved, many elderly, who in earlier years would have lived with their adult children, found it possible to afford their own independent households. Similarly, children could afford to leave the family home at an earlier age and it became less necessary for two or more families to share living quarters. While economic

²A household is defined as the individual or group of individuals occupying a dwelling unit. Therefore, the number of occupied units equals the number of households by definition.

CHART 1
 CHARACTERISTICS OF HOUSING STOCK, TOTAL U. S.,
 1950, 1960, 1970



- (1) LACKING COMPLETE PLUMBING - HOUSING UNITS WHICH LACK ONE OR MORE PLUMBING FACILITIES OR HAVE A FACILITY USED ALSO BY OCCUPANTS OF ANOTHER UNIT.
- (2) OVERCROWDED - 1.01 OR MORE PERSONS PER ROOM.
- (3) DILAPIDATED - HOUSING WHICH DOES NOT PROVIDE SAFE AND ADEQUATE SHELTER, AND ENDANGERS HEALTH, SAFETY OR WELL BEING OF OCCUPANTS. DEFECTS ARE SO CRITICAL OR WIDESPREAD THAT THE STRUCTURE SHOULD BE EXTENSIVELY REPAIRED, REBUILT, OR TORN DOWN.

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS,
CENSUS OF HOUSING, 1950, 1960, 1970.

TABLE 1

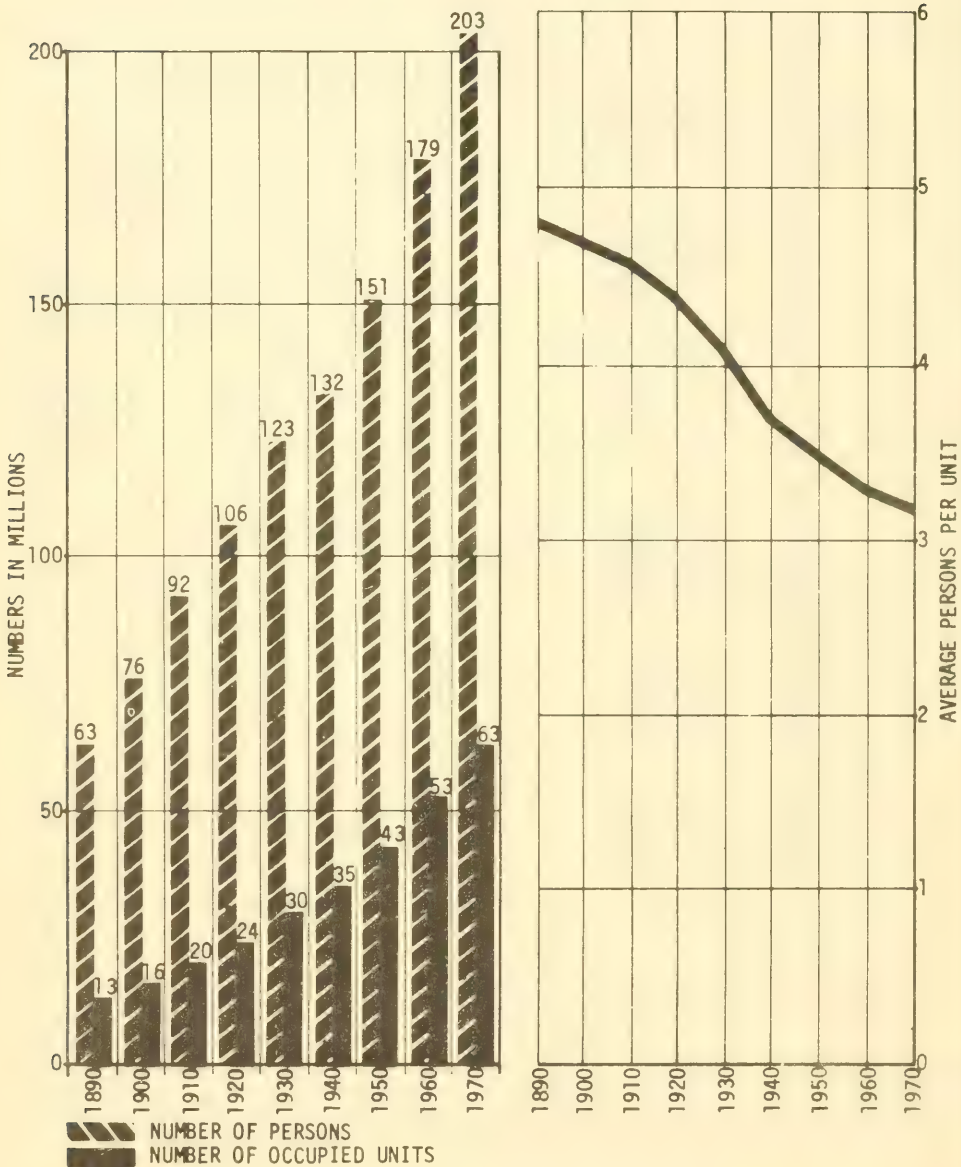
SELECTED CHARACTERISTICS OF THE HOUSING STOCK BY REGION 1970

	TOTAL YEAR-ROUND UNITS (NUMBER)	UNITS IN ONE-UNIT STRUCTURES (PERCENT)	UNITS IN STRUCTURES OF 5 OR MORE UNITS (PERCENT)	UNITS OVER 30 YEARS OLD (PERCENT)	UNITS LACKING SOME OR ALL PLUMBING FACILITIES (PERCENT)	MEDIAN ROOMS PER UNIT (NUMBER)	MEDIAN PERSONS PER UNIT (NUMBER)
NORTHEAST	16,197,862	54.2	22.4	55.2	3.9	5.1	2.7
NORTH CENTRAL	18,675,232	71.9	11.5	49.1	6.2	5.1	2.7
SOUTH	20,883,566	77.7	9.8	29.4	11.9	4.9	2.7
WEST	11,942,424	69.9	16.9	26.8	3.3	4.7	2.5
U.S.	67,699,084	69.1	14.5	40.6	6.9	5.0	2.7

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING.

CHART 2

POPULATION AND NUMBER OF OCCUPIED UNITS : 1890-1970

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING.

factors undoubtedly played a major role in these developments, changing social customs probably also influenced the rate of change.

As the housing stock grew to match the increase in the number of households, there were notable changes in the composition of housing production. (Chart 3) The most significant change has been the growing importance of mobile homes.³ In 1950, only 63,100 mobile homes were shipped. By 1960, shipments had grown to 103,700 and by 1970, total annual shipments were 401,190. While shipments may be lower in the last 5 months of 1973 than in the first 7 months, they should exceed 600,000 units for the entire year.

The relative importance of multifamily dwellings has also grown, although not at the same rate as the importance of mobile homes. In 1960, about 22 percent of all conventional starts consisted of multifamily dwellings, but by 1972, the proportion had grown to about 45 percent.

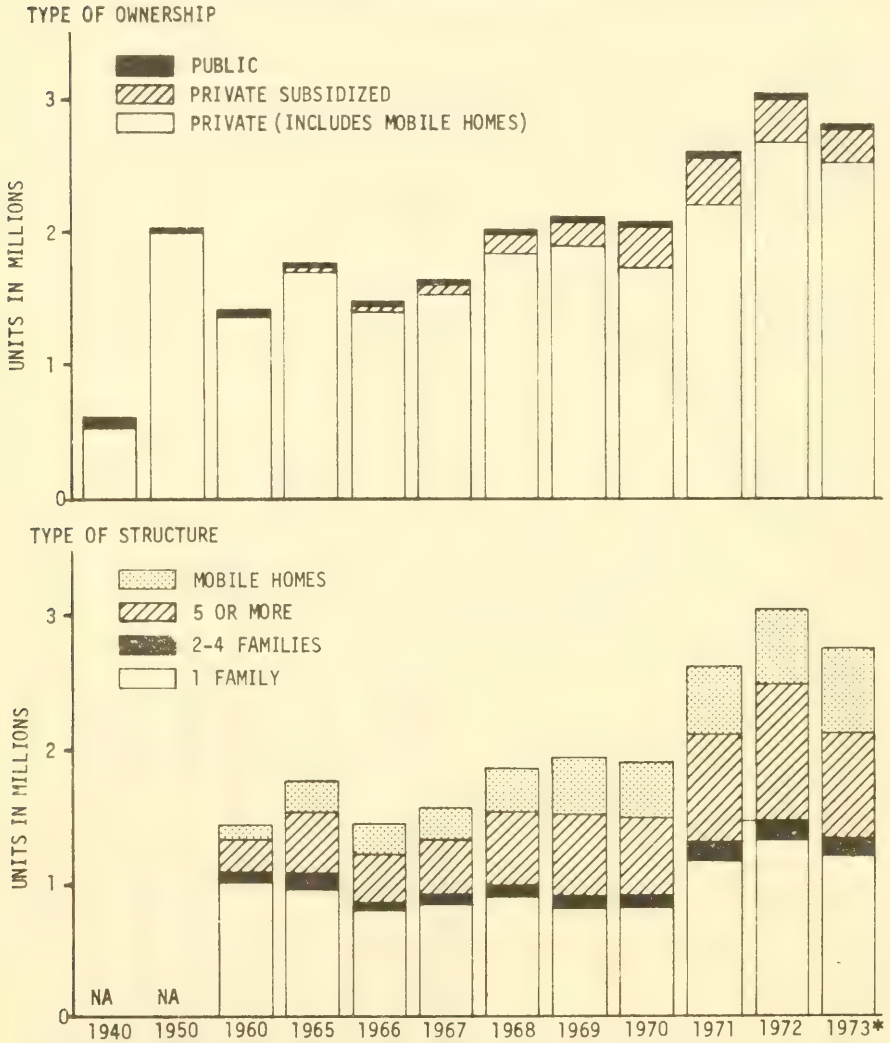
THE HOUSING OF THE TYPICAL AMERICAN

Table 2 illustrates the important changes which have occurred in the characteristics of typical American households over the period 1950 to 1970. The median household income of owner's grew 188.7 percent over the period while the median income of renter's grew 125.0 percent. Over the same two decades the cost of living as measured by the Consumer Price Index grew only 61.3 percent, and the consequent improvement in the standard of living allowed buyers and renters to increase the size and improve the quality of their living quarters. More precisely, the median number of rooms occupied rose from 4.6 to 5.1 while the median value of homes fell from 2.09 times income in 1950 to 1.79 times income in 1970; however, the rent-income ratio rose from 17.9 to 20.9 percent over the same period. Households also became less crowded with the median number of persons per room falling from somewhat below 0.75 to 0.50.

However, the data for the "typical American" mask important differences between the living conditions in central cities, suburbs, and rural areas. Table 3 shows that median incomes for owners and renters are highest in the suburbs. The median home value to income ratio is also highest in the suburbs as is the

³The term "mobile" home is a misnomer. Typically, a mobile home remains on one site during its entire useful life.

CHART 3
TOTAL NEW HOUSING UNITS PRODUCED FOR SELECTED YEARS



SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CONSTRUCTION REPORTS, SERIES C 20; DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

TABLE 2

CHARACTERISTICS OF THE TYPICAL AMERICAN HOUSEHOLD

CHARACTERISTIC	1950	1960	1970
MEDIAN INCOME OF FAMILIES AND PRIMARY INDIVIDUALS			
OWNER	\$3,360	\$5,900	\$9,700
RENTER	\$2,800	\$4,100	\$6,300
MEDIAN HOME VALUE ⁽¹⁾	\$7,400	\$11,900	\$17,100
MEDIAN VALUE/INCOME RATIO ⁽¹⁾	2.09	1.92	1.79
MEDIAN GROSS RENT ⁽²⁾	\$42	\$71	\$108
MEDIAN GROSS RENT AS PERCENTAGE OF INCOME	17.9%	19.7%	21.0%
MEDIAN PERSONS PER HOUSEHOLD	3.1	3.0	2.7
MEDIAN NUMBER OF ROOMS	4.6	4.9	5.1
MEDIAN PERSONS PER ROOM	LESS THAN 0.75	0.59	0.50

(1) ONE FAMILY HOMES ON LESS THAN 10 ACRES WITH NO BUSINESS ON PROPERTY.

(2) EXCLUDES ONE FAMILY HOMES ON 10 ACRES OR MORE.

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CENSUS OF HOUSING, 1950, 1960, 1970.

TABLE 3

GEOGRAPHIC DIFFERENCES IN HOUSING MARKETS, 1970

CHARACTERISTIC	CENTRAL CITY	METROPOLITAN SUBURBS	NON-METROPOLITAN
MEDIAN INCOME OF FAMILIES AND PRIMARY INDIVIDUALS			
OWNER	\$10,100	\$11,600	\$7,500
RENTER	\$6,100	\$7,700	\$5,300
MEDIAN HOME VALUE ⁽¹⁾	\$16,400	\$20,800	\$12,200
MEDIAN VALUE/INCOME RATIO ⁽¹⁾	1.72	1.86	1.72
MEDIAN GROSS RENT ⁽²⁾	\$107	\$130	\$84
MEDIAN GROSS RENT AS PERCENTAGE OF INCOME ⁽²⁾	21.8%	20.7%	19.5%
MEDIAN PERSONS PER HOUSEHOLD	2.4	3.0	2.7
MEDIAN NUMBER OF ROOMS	4.7	5.3	5.1
MEDIAN PERSONS PER ROOM	LESS THAN .50	.53	LESS THAN .50

(1) ONE FAMILY HOMES ON LESS THAN 10 ACRES WITH NO BUSINESS ON PROPERTY.

(2) EXCLUDES ONE FAMILY HOMES ON 10 ACRES OR MORE.

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING.

median number of rooms. But the number of persons per room is somewhat greater than in central cities. However, this statistic probably obscures important differences in the degree of overcrowding for many central city households. The median for the central cities is lowered by the presence of large numbers of single person households and these are rare in the suburbs.

In general, the medians for central city and non-metropolitan areas also hide the poor housing conditions of the low-income populations in these areas, and these are considered in detail in the next section.

THE HOUSING OF LOW-INCOME AMERICANS

A low income makes it difficult for consumers to afford good housing just as it is difficult for them to afford adequate food, clothing, and other essentials of life. In other words, the less than average quality housing so often occupied by low-income families is only one manifestation of fundamental social and economic problems.

The size and the composition of the Nation's low-income population has changed over time. The number of people whose incomes were such that they were under the Bureau of Census low-income threshold⁴ has declined significantly during the decade of the 1960's -- from 39.9 million or 22 percent of the total population in 1960 to 25.5 million or 13 percent of the 1970 population. During the same period the aged became a greater proportion of the low-income population increasing from 14 to 18 percent of the total. The only group to increase in absolute number was the population in non-white female headed households. This group grew in number by 700,000 in the 10 year period between 1960 and 1970 and, as a percentage of the total low-income population, nearly doubled from 8 to 15 percent. The percentage of all non-whites of low-income increased from 29 to 31 percent while their numbers dropped from 11.5 to 8.0 million. (Table 4)

⁴In 1960 the low-income threshold for a nonfarm family of four equaled \$3,022. In 1970, the threshold for the same family was \$3,968. In 1972, this figure had increased to \$4,275 and the number of persons below the low-income threshold had decreased to 24.5 million or 11.9 percent of the population.

TABLE 4

THE COMPOSITION OF THE LOW-INCOME POPULATION

(IN MILLIONS)

CATEGORY ⁽⁴⁾	LOW-INCOME THRESHOLD FOR NONFARM FAMILY OF TWO ADULTS AND TWO CHILDREN			
	1960 = \$ 3,022		1970 = \$ 3,968	
TOTAL NUMBER IN GROUP	39.9	(100%)	25.5	(100%)
AGED	5.7	14%	4.7	18%
DISABLED NON-AGED ⁽¹⁾	.3 ⁽²⁾	1% ⁽²⁾	1.2	5%
NON-AGED , NON-DISABLED	33.8 ⁽³⁾	85%	19.6	77%
WHITE MALE HEAD	18.0 ⁽³⁾	45%	8.4	33%
NON-WHITE MALE HEAD	7.5 ⁽³⁾	19%	3.1	12%
WHITE FEMALE HEAD	5.2 ⁽³⁾	13%	4.3	17%
NON-WHITE FEMALE HEAD	3.1 ⁽³⁾	8%	3.8	15%
NON-WHITE (ALL CATEGORIES)	11.5	29%	8.0	31%

(1) PERSONS WHO DID NOT WORK IN 1960 (OR 1970) AND REPORTED THE PRIMARY REASON AS ILLNESS OR DISABLED (AGES 14-64, ONLY)

(2) FAMILY HEADS ONLY, AGE 25-64

(3) INCLUDES DISABLED OTHER THAN FAMILY HEADS, AGE 25-64

(4) CATEGORIES PATTERNED AFTER MICHIGAN RESEARCH CENTER STUDIES

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-60, NOS. 68 AND 81.

The decline in the absolute size of the low-income population over the long run reflects the fact that the real incomes of those at the low end of the income distribution have grown. The median income of the households in the lowest 20 percent of the income distribution was 16.5 percent of the national median income in 1970 compared to 16.3 percent in 1960 and 14.3 percent in 1950.

The most dramatic changes have been in the incomes of the lowest fifth of the rural population, whose median income rose from 12.8 to 16.0 percent of the national median between 1960 and 1970, and for the elderly whose median income also increased relative to the national median -- up from 8.0 percent in 1960 to 10.9 percent of the national median in 1970 -- primarily because of increased Social Security benefits and private pension plan payments. (Chart 4)

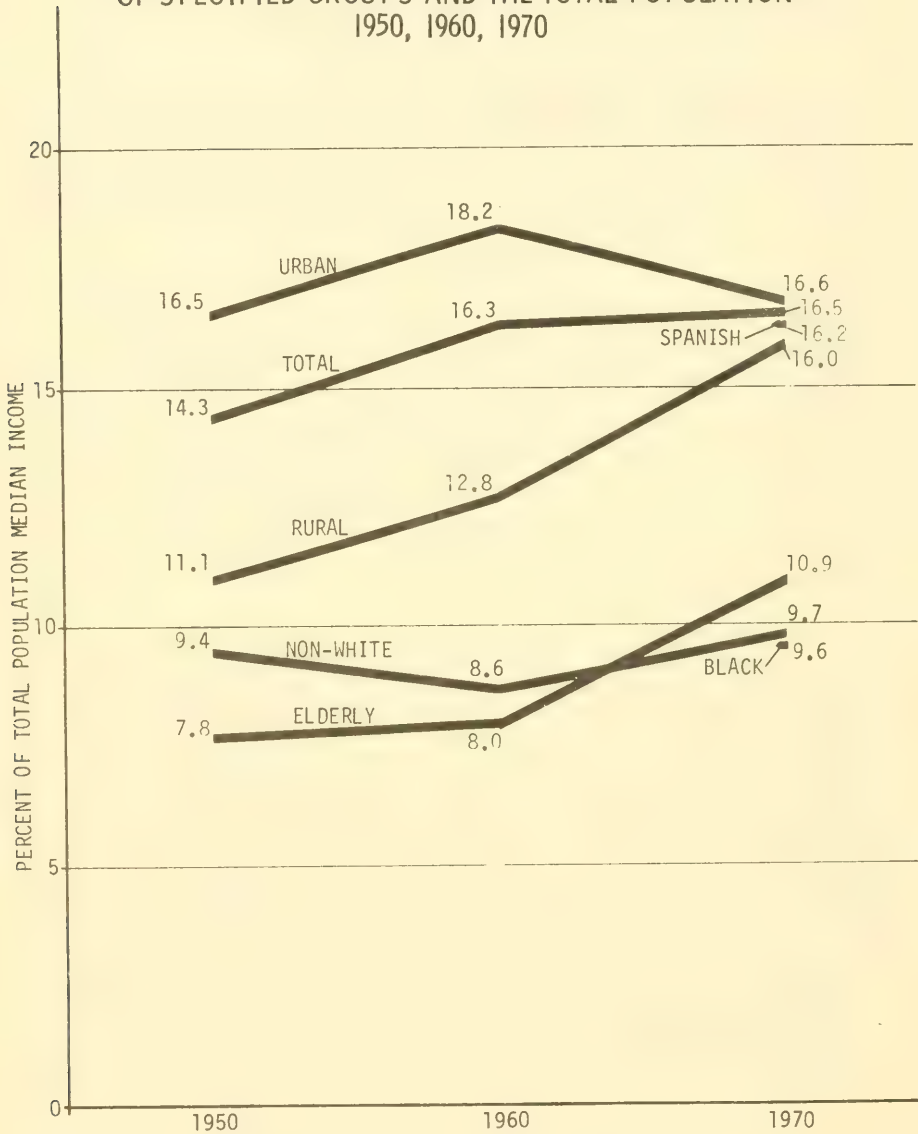
The growth in the incomes of those at the low end of the income distribution has allowed a significant improvement in the quality of their housing. For the third of the households with the lowest income, the percentage of households occupying housing which lacked complete plumbing facilities dropped by nearly 80 percent between 1950 and 1970 and the percentage of occupied units which were overcrowded⁵ dropped by more than half over the same period (Chart 5). A part of this improvement is the result of the development of the mobile home industry which has provided a low-cost housing alternative for those with modest incomes. Fifty percent of the households who occupy mobile homes in 1970 had incomes of less than \$7,000.

Nevertheless, low-income households still occupy poor quality housing far out of proportion to their numbers. Both low-income owners and renters live in units which are more expensive relative to their means than the nationwide median owner and renter. While, in 1970, the typical renter spent between 15 and 25 percent of his annual gross income on housing, those at the bottom of the income distribution typically spend over 35 percent of their annual gross income for housing. Those below the low-income threshold are much more likely to live in ill equipped and overcrowded housing. While only 32 percent of all renters had incomes below the 1970 low-income threshold, they occupied 63 percent of the

⁵An "overcrowded" household is one with more than 1 person per room. While an overcrowded unit is not necessarily structurally deficient or lacking equipment, it is an indicator of poor living conditions.

CHART 4

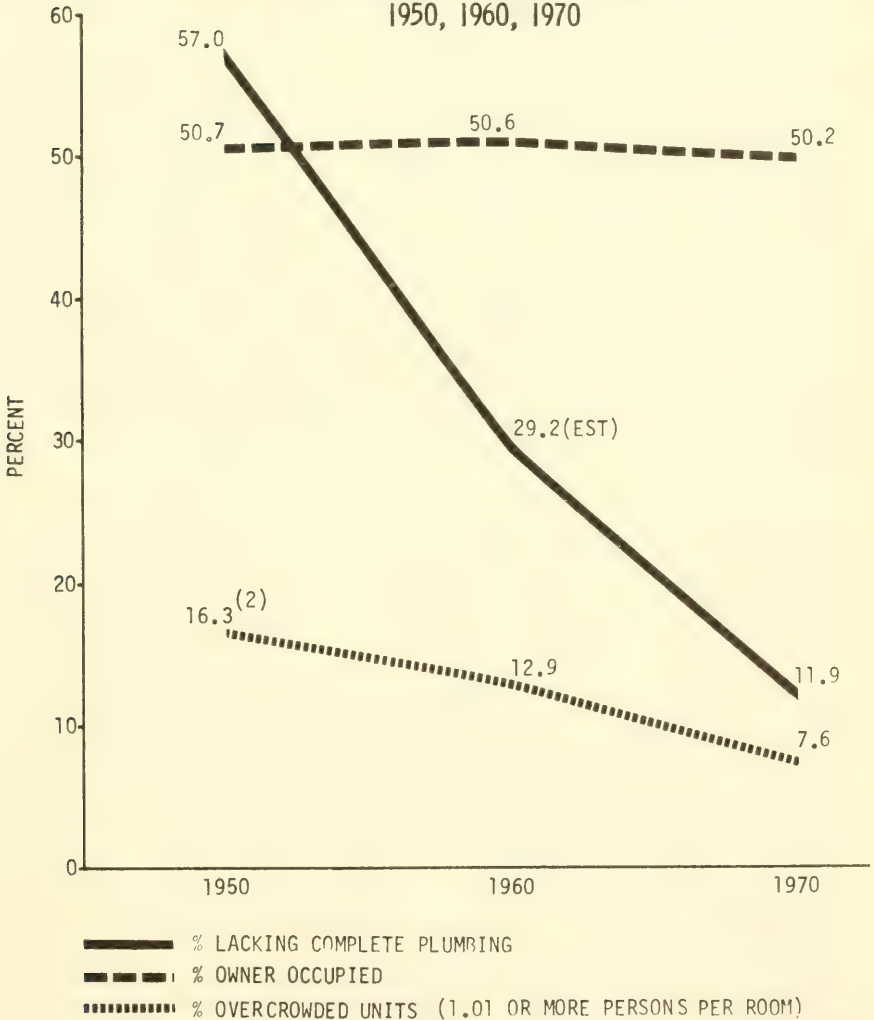
COMPARISON OF MEDIAN INCOME OF THE LOWEST 20%
OF SPECIFIED GROUPS AND THE TOTAL POPULATION
1950, 1960, 1970



SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS,
CENSUS OF POPULATION, 1950, 1960, 1970.

CHART 5

CHARACTERISTICS OF HOUSING OF LOWEST THIRD OF INCOME DISTRIBUTION⁽¹⁾ 1950, 1960, 1970



- (1) INCOMES OF FAMILIES AND PRIMARY INDIVIDUALS:
 1950-UNDER \$2,000 (34.4% OF HOUSEHOLDS)
 1960-UNDER \$4,000 (37.5% OF HOUSEHOLDS)
 1970-UNDER \$6,000 (35.4% OF HOUSEHOLDS)
- (2) NON-FARM ONLY

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS,
CENSUS OF HOUSING, 1950, 1960, 1970.

rental units which lacked complete plumbing facilities in 1970. Low-income homeowners represented only 19 percent of the households who were homeowners, yet they lived in 57 percent of all the occupant-owned housing without complete plumbing.

The problem of low incomes afflicts a relatively high proportion of the rural population. In 1970, 20 percent of households living in non-metropolitan areas were below the low-income line whereas only 13 percent were below the threshold in metropolitan areas. As a result, rural areas (open country and urbanized places with fewer than 2,500 residents) contain a disproportionate share of the country's poor housing. While such areas contained only 27 percent of the population in 1970, they contained 62 percent of the occupied units lacking complete plumbing, 31 percent of the crowded units (more than one person per room), and 38 percent of severely crowded units (more than 1.5 persons per room). The incidence of housing deficiencies is also more common for blacks and other minorities in rural than in urban areas. For instance, of the black-occupied rural housing units in 1970, 30 percent were overcrowded and 61 percent lacked complete plumbing, compared to 18 percent and 8 percent, respectively, for black-occupied urban units.

The problem of low-income also affects the quality of the housing of the elderly. While Chart 4 shows that the incomes of the elderly poor rose relative to the rest of the population between 1960 and 1970, it was from a very low level. Of the 12.4 million households with heads aged 65 and over, in 1970, 5.8 million or 47 percent still had incomes of less than \$3,000.

In 1970, 14.6 percent of all elderly households receiving less than \$3,000 income had incomplete plumbing compared to 9.1 percent for all elderly households and 5.9 percent for the population as a whole. Overcrowding is one housing problem not faced by elderly headed households. Only 1 percent were overcrowded in 1970 compared to 8 percent of all households in the United States.

A difficult problem faced by the elderly is the need to spend such a large share of their income on housing. A substantial share devote more than 35 percent of their income for shelter and there are instances in which they spend more than 100 percent, necessitating the use of accumulated savings. This makes them highly susceptible to unexpected changes in their circumstances -- serious illness, tax increases and inflation.

Table 4 showed that non-white, female-headed households became a much higher proportion of the low income population between 1960 and 1970. This was the only group to grow in absolute numbers over the period. The data on black, female-headed households containing two or more persons show that they tend to be very poor with a median income of only \$3,576. About two-thirds live in central cities and more than 24 percent are in overcrowded quarters. In other words, the incidence of over-crowding is about three times the national level. About 15 percent lack complete plumbing or more than twice the national level of 5.9 percent.

It is often asserted that the housing conditions of the poor will be gradually improved by the process of "filtering"; that is to say, as the income of the bulk of the population rises and allows it to improve its housing conditions, they will vacate slightly lower quality dwellings leaving them available for the poor who will move up from still lower quality housing. A variant of this argument suggests that as the Government subsidizes new housing for moderate-income groups and they move into the new units, an increased supply of existing suitable housing will be made available for the poor.

This process certainly does work in the short run. In the very long run, however, natural economic forces tend to reduce the filtering benefits accruing to individuals whose income remains unchanged. The basic problem is that the amount that poor people can afford for their housing is constrained by their meager budget. At the same time, investments in maintaining the stock of housing must earn an economic return. Therefore, while filtering temporarily allows poor persons to inhabit a better house, they or their landlord will not be able to maintain it unless the occupant's income (or rent) is increased. If housing expenditures do not keep pace with maintenance and other costs, the quality of the house is gradually allowed to deteriorate. Of course, this may take a very long time, and before it happens the poor family may be able to move yet again to a higher quality dwelling just vacated by someone else whose income has risen. In other words, the market is constantly in motion, and it may never reach a long-run equilibrium in which housing conditions are essentially determined by the amount people are willing and able to pay and by the rate of return on investments in housing. However, the long-run forces are always pushing the market in this direction and this reduces the effectiveness of the filtering process. Clearly, a more

certain improvement in the housing conditions of the poor can only be achieved if their effort to find housing is subsidized, or their income is increased by other means.

Empirical studies of filtration are in a primitive state and it is impossible to assess the importance of the phenomena described above.⁶ Undoubtedly, conditions vary greatly from city to city and from neighborhood to neighborhood within cities.

The discussion thus far has focused on the physical characteristics of the housing of the low-income population and has not considered the crucially important issue of the environment in which that housing is located. Housing problems are particularly acute when they are concentrated in low-income neighborhoods. The next section discusses the housing conditions in such neighborhoods and then considers some of the most important features of the low-income environment.

LOW-INCOME NEIGHBORHOODS

Fifty low-income neighborhoods were selected for analysis in this study. They are listed in the appendix. All 50 were classified as "major concentrations of poverty" after the 1960 Census and still had high concentrations of low-income households in 1970.⁷ The neighborhoods selected are indicative of those neighborhoods which have had concentrations of the Nation's worst housing over a long period of time.

Forty of the 50 neighborhoods were located in central cities with a population of more than one-half million, and the selection included neighborhoods from all regions of the country, with the largest number (18) in the Northcentral United States and 15 located in the South. The West contained the fewest in number -- seven neighborhoods; the remaining 10 were located in the Northeast.

⁶For a detailed description of the theory of filtering and a review of related empirical studies, see "An Analysis of the Filtering Process with Special Reference to Housing Subsidies," a study prepared by W.B. Brueggeman for the National Housing Policy Review, Department of Housing and Urban Development, June 8, 1973.

⁷Over 20 percent of the neighborhood's population lived in households with incomes under the low-income threshold.

During the 10 year period from 1960 to 1970, there were dramatic changes in the population, the racial composition and the condition of the housing stock in virtually all of the 50 neighborhoods. All but one declined in total population -- the drop ranging from 3 to 63 percent. The only exception was a neighborhood of Miami, Florida, which experienced a 28 percent increase in population as a result of a large in-migration of Cuban refugees.

In all 50 neighborhoods, the white population declined. In 11 of the neighborhoods there was less than one white person present in 1970 for every four present in 1960.

In 24 of the neighborhoods, the number of blacks increased, rising more than 50 percent in seven neighborhoods. The number of Spanish-Americans increased in 33 of the neighborhoods -- in some cases by more than five times.

Interestingly, while the whites were generally moving out of the low-income neighborhoods and in one-half of the neighborhoods minorities were moving in, the median standard of living in most neighborhoods improved. The median gross income of families rose more rapidly than the cost of living in 43 neighborhoods while the real income of unrelated individuals rose in 32. Moreover, incomes rose more than rents in 44 of the 50 neighborhoods, the exceptions all being in large cities -- Chicago, Newark, New York City, and San Francisco.

The ratio of vacant to occupied units rose in 31 of the 50 neighborhoods while the vacancy rate for the Nation as a whole fell between 1960 and 1970. With more vacancies and hence with a greater choice of units the inhabitants were able to upgrade the quality of their housing. The percentage of occupied units lacking complete plumbing fell in all but three neighborhoods and the proportion of overcrowded households decreased in all but eight.

Overall, the changes in the 50 low-income neighborhoods indicate some surprising results. The neighborhoods were selected with an expectation of neighborhood decline and yet, it was found that for virtually all neighborhoods studied, housing conditions and real incomes actually improved. However, all indices still revealed relatively poor housing conditions. In 17 neighborhoods the percentage of households lacking complete plumbing in 1970, was twice as high as the national average. Overcrowding rates were greater than average in all but three, and in 10 the proportion of overcrowded units exceeded 20 percent compared to a national average of 8.2 percent.

Overall, the neighborhood data suggest two conclusions. First, housing conditions tend to improve even in the worst neighborhoods if real incomes rise. Second, even in some neighborhoods where real incomes did not rise, there was an improvement in housing conditions, strongly suggesting that the process of filtration was working effectively. Only in a few cases is there evidence that new construction aided in improving the quality of the occupied housing stock.

While the physical characteristics of the housing in the neighborhoods studied above were improving, it is not clear that the environment in low-income neighborhoods in general showed similar improvements during the 1960's.

Typically, low-income neighborhoods receive relatively high levels of public service inputs, such as police patrolling, fire protection, and sanitation services,⁸ because the problems attacked by these services are most serious in these areas. Despite the high levels of public service inputs, the problems remained severe and may have gotten worse through the 1960's.

There is much disagreement on commonly-used statistics, but it is generally believed crime became a more serious problem in low-income neighborhoods between 1960 and 1970.⁹ The evidence for fire is scantier, but seems to point in the same direction.¹⁰ Also, there is general agreement that the quality of schools in low-income neighborhoods remain far below the national average.

⁸Charles S. Benson and Peter B. Lund, "Neighborhood Distribution of Local Public Services," Berkeley: University of California, 1969, and John Weicher, "The Allocation of Police Protection by Income Class," Urban Studies, February 1973.

⁹National Commission on the Causes and Prevention of Violence, To Establish Justice to Insure Domestic Tranquility, Washington, D.C.: Government Printing Office, 1969, pp. 42-43.

¹⁰Jonathan R. Laing, "Arson in the Ghetto," Wall Street Journal, April 9, 1970.

It should be noted that the problems of the environment of low-income neighborhoods afflict all who live there regardless of their income class. While there is a great deal of segregation by income class within large American cities, it is far from complete. Although in Birmingham 70 percent of all low-income households were in low-income neighborhoods, in 1970, in Chicago only 34 percent of the households below the poverty level lived in low-income neighborhoods and 70 percent of the households living in such neighborhoods were above the low-income line.¹¹ Patterns similar to Chicago occur in many other American cities.

However, despite these data, there is clearly a disproportionate concentration of poverty within the central cities. Therefore, improvements in the physical condition of their housing by subsidized new construction in these areas or by other means only solves part of the problem. Indeed, it may worsen the situation by reducing the migration of the poor out of an unsuitable environment. In other words, the housing problems of low-income groups cannot be adequately attacked without a variety of complementary policies which improve the environment in which their housing is located.

HOUSING FOR MINORITY GROUPS

One of the main reasons that minorities tend to be housed poorly is that they comprise a disproportionate share of the low-income population. While the number of non-whites¹² below the low-income line fell from 11.5 million in 1960 to 8.0

¹¹Office of Economic Opportunity, special tabulation of 1970 Census of Population.

¹²The category "white" includes persons who indicated their race as white, as well as persons who did not classify themselves in one of the specific race categories on the questionnaire but entered Mexican, Puerto Rican, or a response suggesting Indo-European stock. The category "Negro" or black includes persons who indicated their race as "Negro" or black, as well as persons who did not classify themselves in one of the specific race categories on the questionnaire but who had such entries as Jamaican, Trinidadian, West Indian, Haitian, and Ethiopian. The term "blacks and other races" or "non-white" includes persons of all races other than white.

million in 1970, 31 percent of the non-white population still remained in this category as compared to 13 percent of the entire population. Moreover, the median income of the poorest one-fifth of the non-whites failed to make significant gains relative to the median income of the whole population. (See Chart 4)

In addition to the problems posed by their low incomes, non-whites still face housing discrimination, and strong patterns of racial segregation still prevail in most American cities. However, growing incomes and anti-discrimination laws have allowed significant housing gains over the last two decades. The proportion of non-white households lacking complete plumbing plummeted from 70.5 percent in 1950 to 16.8 percent in 1970. The incidence of overcrowding fell from 28.3 percent in 1960 to 19.9 percent in 1970. However, the improvement in the housing conditions of non-whites has not been great enough to eliminate major housing problems for the Nation's minorities. (Chart 6)

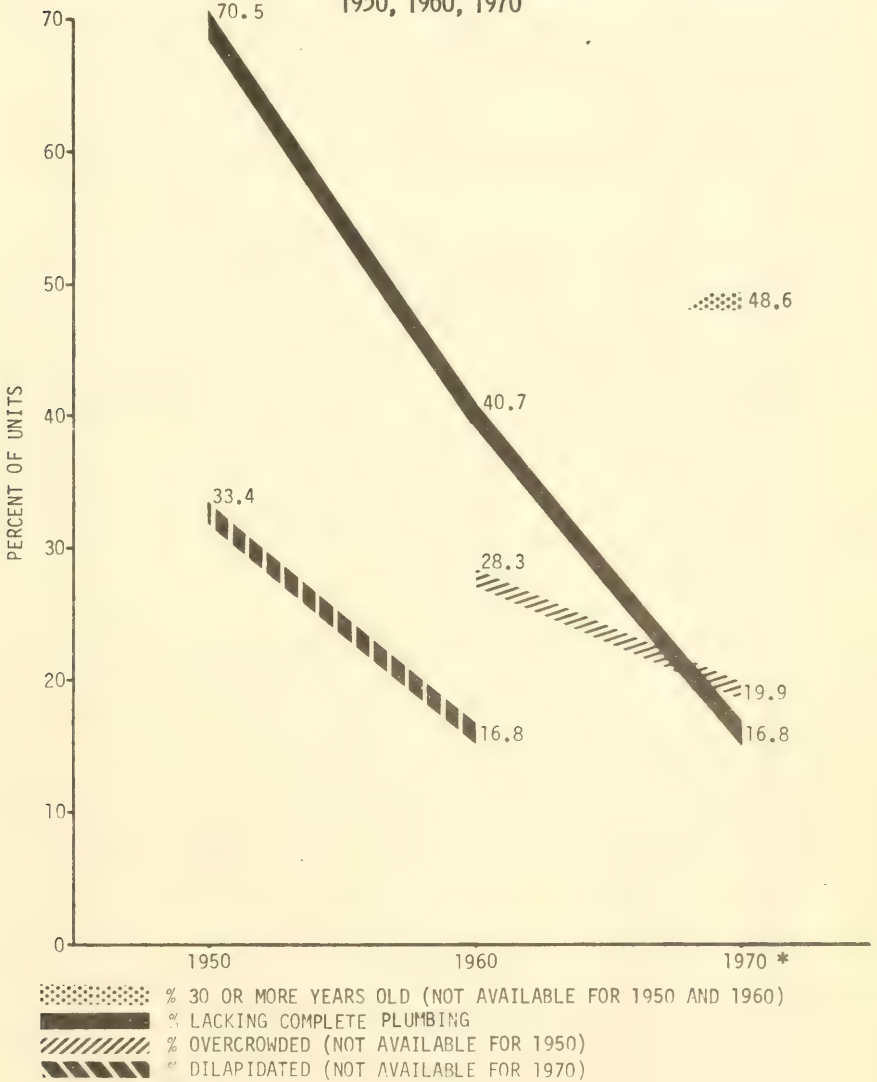
Table 5 compares the housing and incomes of the median black household to that of the median Spanish-American households and the median for the whole United States population. For both renters and owners, the black median income is lowest with the Spanish-American medians being between those for blacks and the medians for the whole population. The same ranking applies to the median home value and median rent paid. The median Spanish-American household is larger than that of the blacks and occupies fewer rooms.

Both groups undoubtedly still face housing discrimination, but only discrimination against blacks has been studied systematically. Because they face a restricted housing supply, blacks appear to pay more than whites of equal income for otherwise identical housing. The results of extensive empirical studies are not conclusive enough to specify the magnitude of these discriminatory premiums because it is difficult to isolate statistically the impact of discrimination from a myriad of other economic and locational variables. However, the studies that have been made of this difficult problem in several cities suggest that a non-white buying a single-family home must pay 5 to 20 percent more than a white buying comparable living quarters.¹³

¹³For a review of the literature see John Kain, "Background Paper on Housing Market Discrimination and its Implications for Housing Policy," a report prepared for National Housing Policy Review, Department of Housing and Urban Development, May 24, 1973.

CHART 6

CHARACTERISTICS OF HOUSING STOCK, NON-WHITE HOUSEHOLDS 1950, 1960, 1970



* 1970 DATA FOR BLACK OCCUPIED UNITS ONLY

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS,
CENSUS OF HOUSING, 1950, 1960, 1970.

TABLE 5

CHARACTERISTICS OF BLACK AND SPANISH AMERICAN HOUSEHOLDS, 1970

CHARACTERISTIC	SPANISH AMERICAN HOUSEHOLDS	BLACK HOUSEHOLDS	ALL HOUSEHOLDS
MEDIAN INCOME OF FAMILIES AND PRIMARY INDIVIDUALS			
OWNER	\$8,850	\$6,500	\$9,700
RENTER	\$5,740	\$4,300	\$6,300
MEDIAN HOME VALUE ⁽¹⁾	\$14,900	\$10,700	\$17,100
MEDIAN VALUE/INCOME RATIO ⁽¹⁾	1.72	1.74	1.79
MEDIAN GROSS RENT ⁽²⁾	\$99	\$89	\$108
MEDIAN GROSS RENT AS PERCENTAGE OF INCOME ⁽²⁾	20.6%	23.6%	21.0%
MEDIAN PERSONS PER HOUSEHOLD	3.6	3.0	2.7
MEDIAN NUMBER OF ROOMS	4.5	4.6	5.1
MEDIAN PERSONS PER ROOM	.77	.63	.50

(1) ONE FAMILY HOMES ON LESS THAN 10 ACRES WITH NO BUSINESS ON PROPERTY.

(2) EXCLUDES ONE FAMILY HOMES ON 10 ACRES OR MORE.

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF HOUSING.

However, the housing problems of blacks and other minority groups go far beyond this discriminatory premium. Segregation in low-income neighborhoods can lead to a highly unsatisfactory environment. Blacks confined to such an environment can improve their housing if they have sufficient income, but they still may have to endure high crime rates and send their children to inadequate schools. As a result, the improvement in housing conditions for non-whites shown in Chart 6 may tell only a partial story and the quality of the non-white environment may not have improved nearly as dramatically.

In 1970, the approximately 764,000 American Indians constituted the poorest minority of all. The median family income of this group was only \$5,832 in 1970, almost \$3,800 below the national median family income. As their income would indicate, this minority is very poorly housed. Of the approximately 180,000 American Indian households, about 47,000 or 26 percent occupied housing without complete plumbing facilities. A full 46 percent of all rural Indian households -- 49 percent of all Indian households -- were living in dwellings lacking complete plumbing facilities, in 1970. Thirty-one percent of all American Indian households lived in overcrowded housing in 1970, compared with only 8 percent of all American households. Clearly, American Indians occupy the worst housing of any American minority.

MIGRATION

While increased incomes have facilitated a vast improvement in the quantity and quality of the Nation's housing stock, migration has been an important force determining its location. The most important movement has been from rural to metropolitan areas.¹⁴ In 1900, only 40 percent of the Nation's inhabitants lived in an urban environment. By 1970, the proportion in metropolitan areas had risen to 69 percent with a substantially higher percentage of the population living within commuting distance of metropolitan areas. In part, this trend reflects the steady decline in the relative proportion of the population engaged in farming. As the number of people engaged in

¹⁴ Metropolitan areas and Standard Metropolitan Statistical Areas are used interchangeably in this chapter to refer to all Standard Metropolitan Statistical Areas as defined by the Office of Management and Budget. The 1970 Census definition was "a county or group of contiguous counties which contain at least one city of 50,000 inhabitants or more, or 'twin cities' with a combined population of at least 50,000." There were 247 such areas in 1970.

farming declined from almost 32 million in 1920 to just under 10 million in 1970 their proportion of the total population declined from 30 percent to 5 percent.

Over 30 percent of the Nation's growth during the 1960's has occurred in metropolitan areas which in 1970 had populations of one to three million people. In 1960, these cities and their surrounding suburbs had a total population of 35.4 million. Ten years later their population had grown to 42.9 million.

Over 25 percent of the increase in the population of metropolitan areas between 1960 and 1970 resulted from net in-migration. The remaining three-fourths was the result of natural increase -- more births than deaths. In 11 of the 19 Standard Metropolitan Statistical Areas with the greatest increase in population from 1960 to 1970, migration accounted for more than 50 percent of the population increase. Nine of these areas were located in the Southeastern and Southwestern portions of the country. (Table 6) During the 1960's, the most rapid growth occurred in Southern suburbs where the population rose 46.8 percent in 10 years. (Table 7)

In almost all regions the population growth was predominantly the result of natural increase. The one exception was the West in which 43 percent of the total population growth was due to in-migration. (Table 8) In the North Central United States, there was a net loss due to net out-migration of 752,000 persons.

As indicated by Table 7, the population of the central cities has not grown nearly as rapidly as their suburbs. In the Northeast, the total central city population declined 3.3 percent between 1960 and 1970. In the 10 major metropolitan areas with the greatest growth during the 1960's, all had larger suburban populations at the end of the decade than they had at the start, but only five contained central cities which had more inhabitants. Of these, four were in the South or West -- New York City being the only exception. Of the 10 Standard Metropolitan Statistical Areas with the least growth, all but two had declining central city populations. (Table 9)

There have been other changes in growth and migratory patterns. During the 1960's, there was a continuing shift in the balance of the American population away from the Northeast and North Central regions. Although all regions experienced absolute increases in population, there was more growth in the South and the West.

TABLE 6

TOTAL POPULATION CHANGE AND NET MIGRATION
 DISTRIBUTION OF NET INCREASE IN METROPOLITAN POPULATION
 IN SELECTED MAJOR SMSA'S - 1960-1970

	POPULATION CHANGE 1960-1970 (THOUSANDS)	NET MIGRATION	
		NUMBER (THOUSANDS)	PERCENT
ALL METROPOLITAN AREAS	19,824	5,307	26.8
SELECTED METROPOLITAN AREAS	9,480	3,524	37.2
LOS ANGELES	993	253	25.5
NEW YORK	834	- 87	-10.4
WASHINGTON D.C.	797	417	52.3
CHICAGO	758	10	1.3
ANAHEIM - SANTA ANA	716	551	77.0
HOUSTON	567	310	54.7
PHILADELPHIA	475	45	9.5
SAN FRANCISCO	461	183	39.7
DETROIT	438	- 48	-11.0
DALLAS	437	243	55.6
SAN JOSE	422	283	67.1
ATLANTA	373	200	53.6
MIAMI	333	254	76.3
SAN BERNARDINO	333	218	65.5
MINNEAPOLIS - ST. PAUL	332	99	29.8
SAN DIEGO	325	169	52.0
SEATTLE	315	184	58.4
PHOENIX	304	188	61.8
BALTIMORE	267	52	19.5

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS,
1972 STATISTICAL ABSTRACT, TABLE 20.

TABLE 7

PERCENTAGE CHANGE IN POPULATION BETWEEN 1960 AND 1970

RESIDENCE	ALL REGIONS	NORTHEAST	NORTH CENTRAL	SOUTH	WEST
UNITED STATES	13.4	9.1	11.0	13.5	24.2
METROPOLITAN	17.0	7.3	17.3	21.7	27.8
INSIDE CENTRAL CITIES	1.5	-3.3	1.1	2.8	8.9
OUTSIDE CENTRAL CITIES	33.5	17.4	35.7	46.8	44.0
NON-METROPOLITAN AREAS	7.1	16.2	1.8	5.9	15.0

TABLE 8

COMPONENTS OF POPULATION CHANGE: 1960 to 1970

REGION AND RACE	NET CHANGE NUMBER (THOUSANDS)	1960 TO 1970 PERCENT	NATURAL INCREASE NUMBER (THOUSANDS)	1960 TO 1970 PERCENT	NET MIGRATION NUMBER (THOUSANDS)	1960 TO 1970 PERCENT
UNITED STATES	23,862	13.3	20,841	11.6	+3,020	1.7
NORTHEASTERN	4,322	9.7	3,998	8.9	324	0.7
NORTH CENTRAL	4,958	9.6	5,709	11.1	-752	-1.5
SOUTH	7,825	14.2	7,232	13.2	593	1.1
WEST	6,756	24.1	3,902	13.9	2,855	10.2
WHITE	18,781	11.8	16,496	10.4	2,284	1.4
NORTHEASTERN	2,744	6.6	3,264	7.9	-520	-1.3
NORTH CENTRAL	3,649	7.6	4,910	10.2	-1,272	-2.6
SOUTH	6,851	15.8	5,045	11.6	1,806	4.2
WEST	5,547	21.5	3,278	12.7	2,269	8.8
BLACK	3,801	20.1	3,886	20.6	-85	-0.5
NORTHEASTERN	1,314	43.4	702	23.2	612	20.2
NORTH CENTRAL	1,126	32.7	744	21.6	382	11.1
SOUTH	753	6.7	2,132	18.8	-1,380	-12.2
WEST	609	56.1	308	28.4	301	27.7

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1971 STATISTICAL ABSTRACT, TABLES 10, 11, 13, 27, 42.

TABLE 9

RELATIVE GROWTH AMONG CENTRAL CITIES & SUBURBS IN METROPOLITAN AREAS OF 1,000,000 OR MORE

(THOUSANDS OF PERSONS)

METROPOLITAN AREAS	NET CHANGE IN POPULATION, 1960-1970,		
AREAS WITH GREATEST GROWTH	TOTAL METROPOLITAN	CENTRAL CITY	SUBURBAN
LOS ANGELES	993	352	642
NEW YORK	834	86	748
WASHINGTON, D.C.	797	- 7	804
CHICAGO	758	-183	941
ANAHEIM - SANTA ANA	716	157	559
HOUSTON	567	295	272
PHILADELPHIA	475	- 54	529
SAN FRANCISCO	461	- 31	491
DETROIT	438	-159	596
DALLAS	437	165	272
AREAS WITH LEAST GROWTH			
ST. LOUIS	258	-128	386
PATERSON-CLIFTON-PASSAIC	172	3	169
NEWARK	167	- 23	190
KANSAS CITY	161	32	130
BOSTON	158	-56	214
CLEVELAND	155	-125	280
MILWAUKEE	125	- 24	149
CINCINNATI	116	- 50	166
BUFFALO	42	- 70	112
PITTSBURGH	- 4	- 84	80

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1970 CENSUS OF POPULATION & HOUSING, PHC(2)-1.

Over the last three decades, blacks have been much more likely to migrate than have whites. The main movement has been from the South to the Northeastern region of the country. Between 1950 and 1960, out-migration from the South by blacks was equivalent to 14.4 percent of the South's 1950 black population. Between 1960 and 1970, the relative importance of out-migration fell only slightly to 12.2 percent. Over the same periods, black in-migration to the Northeast was equivalent to 24.6 percent of the 1950 black population and 20.2 percent of the 1960 black population. Meanwhile, the white population was migrating southward and westward but at a very much slower relative rate. White in-migration to the West between 1950 and 1960 was equivalent to 18.7 percent of the 1950 Western, white population, while white in-migration during the 1960's was equivalent to only 8.8 percent of 1960 population. Net outflows of whites from the Northeast and Northcentral regions was less than 3 percent of the base populations over the same two decades.

Much of the black migration was to the central cities. The black population in these areas grew 50.6 percent between 1950 and 1960 while the white population was growing only 5.7 percent. Between 1960 and 1970 the growth in the black, central city population slowed somewhat to 31.6 percent, but the white central city population actually declined by 1.3 percent.

While the earlier section on low-income neighborhoods suggested that blacks migrating to the central city moved into housing which was far below average in quality, it was probably still superior to the housing left by many in the rural South. In other words, the vast migration which occurred is probably responsible for a part of the improvement in non-white housing noted earlier. Yet, the rapid growth of the black central city population created many social problems because of their low-incomes. Serving the new low-income population was expensive for the central cities and higher tax burdens along with racial discrimination probably contributed to the out-migration of whites to the suburbs. The whites took away a significant tax base as they moved and this has undoubtedly restricted the quantity and quality of public services available to improve the living environments of the remaining central city population.

CONSIDERATIONS FOR THE FUTURE

By the year 1980, the population of the United States is expected to grow to between 228 and 237 million people.¹⁵ These predictions correspond to rates of growth of 11.2 to 15.6 percent over the decade 1970-1980, as compared to a rate of growth of 18.5 during the 1950's and of 13.4 during the decade of the sixties. The smaller rates of growth during the sixties and in the first years of the 1970's reflect the declining birth rate. The lower of the future population predictions is based upon a replacement birth rate, just slightly lower than the birth rate over the last few years.

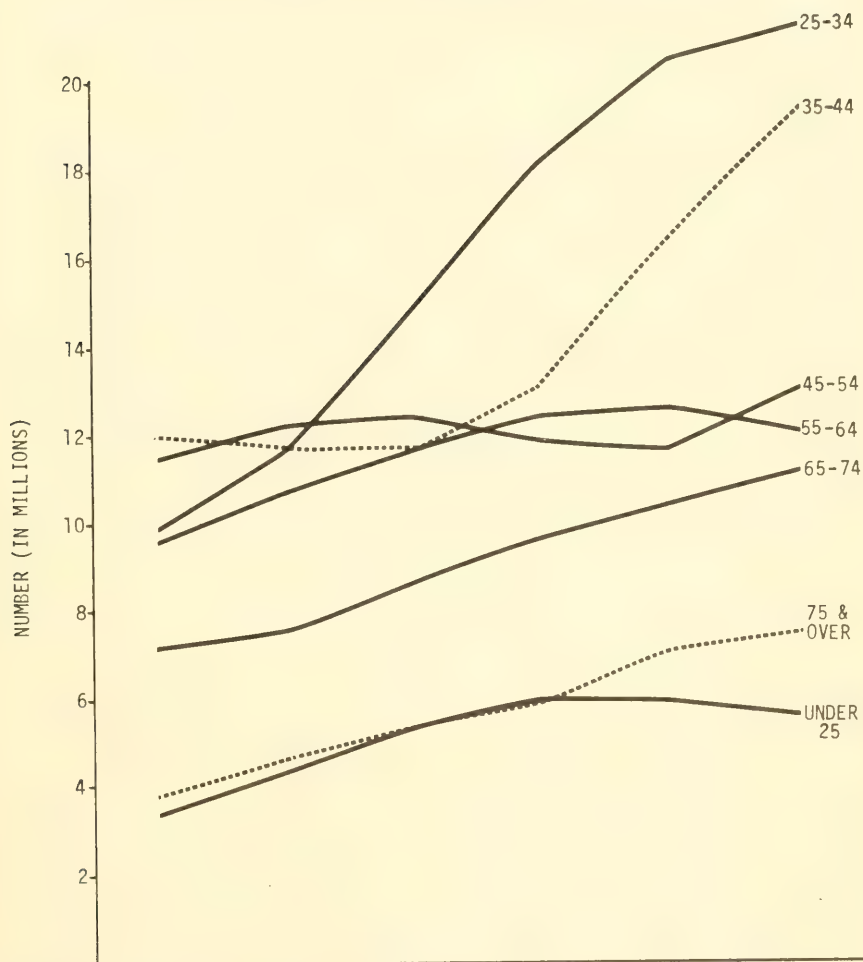
However, during the 1970's there will be a dramatic increase in the proportion of the population between the ages of 25 and 34. While the entire population will grow by about 23 to 32 million persons during the decade of the 1970's the number of persons in this age group alone will increase about 11.6 million from 12.4 percent of the total population in 1970 to about 16 percent in 1980. This large increase will produce a rate of growth in the number of households far greater than the rate of growth of the population. The Bureau of the Census predicts that there will be between 76 and 77 million households by the end of this decade. This corresponds to an increase of 13 or 14 million and a rate of growth of 22 percent over the 10 year period. The 25-34 age group will account for about half of this increase with the number of households headed by individuals between the ages of 25 and 34 growing by 6.1 to 6.6 million. Clearly, the country is entering an era of the young married household -- a legacy of the World War II baby boom.¹⁶ (Chart 7)

¹⁵The range results from the use of different fertility rates in arriving at these predictions. The lower number is based on a replacement birthrate, one which means the population would eventually stabilize. The higher is based on birth-rates of 1964-1965. Department of Commerce, Bureau of the Census, Current Population Reports, Series P-25, No. 476.

¹⁶The predictions of the number of households and the composition by age of head are reported in two series of predictions by the Bureau of the Census. The difference between the two predictions is the result of different assumptions about the proportion of single person households and the number of persons ever married. The first, or higher series is based on the annual rates of change of singles and ever-marrieds during the period 1957-1969. The latter, and larger projection is based on a rate of change for singles and ever-marrieds one-half of that of the first series. The ultimate result should lie in between.

CHART 7

PROJECTED NUMBER OF HOUSEHOLDS BY AGE OF HEAD



YEAR TOTALS (MILLIONS)	1965	1970	1975	1980	1985	1990
	57.251	62.874	70.078	77.296	84.213	90.05

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-25, NO. 476, SERIES 1 PROJECTIONS.

The basic household composition is not expected, however, to change dramatically, but the trend to a higher proportion of single person households is expected to continue. The husband and wife household should continue to predominate, but will probably decline in relative importance. Correspondingly, non-family households, households with one spouse missing and single person households will become relatively more important in terms of their proportion of total households.

Census projections suggest that the rapid rate of expansion in the number of households, which helped to spur the record rates of housing production in recent years, will subside by the 1980's. (Table 10) By 1990, the absolute increase in the number of households is expected to sink to pre-World War II levels.

The reduction in the rate of household formation will take some of the pressures off of housing markets. But it must be emphasized that there are many other factors important to the demand for housing. Units will have to be produced to replace housing lost through deterioration and destroyed by natural disasters, such as fires and floods. As incomes increase individuals will also be able to afford to replace the low quality housing stock at a more rapid rate. In summary, production in the 1980's is likely to exceed that in the 1970's, but the explosive growth of the residential construction industry, which has occurred in recent years, will not have to be repeated.

TABLE 10

RATE OF HOUSEHOLD FORMATION (1960 - 1990)

PERIOD	ABSOLUTE CHANGE (IN MILLIONS)		PERCENT CHANGE FROM PREVIOUS PERIOD	
	SERIES 1	SERIES 2	SERIES 1	SERIES 2
1960 - 1965		(4.5)		(8.4)
1965 - 1970		(5.6)		(9.8)
1970 - 1975	7.2	6.5	11.5	10.4
1975 - 1980	7.2	6.7	10.3	9.6
1980 - 1985	6.9	6.4	8.9	8.4
1985 - 1990	5.8	5.4	6.9	6.6

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-25, No. 476.

APPENDIX

The fifty neighborhoods selected for study were located in the following cities. In some cases, there were more than one neighborhood chosen in a particular city. The neighborhoods are listed by median family income in 1960, from the neighborhood with the highest income to the one with the lowest median family income.

1. Chicago, Illinois
2. Chicago, Illinois
3. Milwaukee, Wisconsin
4. Cleveland, Ohio
5. Baltimore, Maryland
6. Newark, New Jersey
7. Los Angeles, California
8. Boston, Massachusetts
9. Cleveland, Ohio
10. Cincinnati, Ohio
11. Washington, D.C.
12. Chicago, Illinois
13. Cincinnati, Ohio
14. Houston, Texas
15. Chicago, Illinois
16. Minneapolis, Minnesota
17. Queens County, New York
18. St. Louis, Illinois
19. Los Angeles, California
20. Kings County, New York
21. San Francisco, California
22. Philadelphia, Pennsylvania
23. Gary, Indiana
24. Indianapolis, Indiana
25. Pittsburgh, Pennsylvania
26. Chicago, Illinois
27. Detroit, Michigan
28. Denver, Colorado
29. Bronx County, New York
30. Baltimore, Maryland
31. Birmingham, Alabama
32. San Diego, California
33. New Orleans, Louisiana
34. Washington, D.C.
35. Philadelphia, Pennsylvania
36. Miami, Florida
37. St. Louis, Illinois
38. Oakland, California
39. Manhattan, New York
40. Dallas, Texas

41. Los Angeles, California
42. Boston, Massachusetts
43. Atlanta, Georgia
44. Dallas, Texas
45. Atlanta, Georgia
46. St. Louis, Illinois
47. Houston, Texas
48. San Antonio, Texas
49. Memphis, Tennessee
50. Detroit, Michigan

CHAPTER 7

STRUCTURE AND TECHNOLOGY IN THE HOUSING INDUSTRY

This chapter provides an overview of the structure of the U.S. housing industry which for the purposes of this chapter is broadly defined as the builder of housing, the manufacturer of housing and housing components, and the manufacturer of mobile homes. It also highlights the technological and other developments that have brought about change in this industry in the last five years. It is not intended to give a comprehensive analysis of all the industries and government organizations which provide important goods and services to the housing industry. As a caveat, it should also be emphasized at the outset that information available on the housing industry is relatively scarce and sometimes of questionable accuracy. Accordingly, this report attempts to identify all sources as clearly as possible, with the understanding that conclusions and generalizations must, in some cases, be tempered with a certain amount of caution.

THE NATURE OF THE INDUSTRY

The portion of the housing industry dealing with the production of housing units has had two distinct industry sectors -- traditional on-site homebuilding and mobile home manufacturing. The traditional homebuilding industry is extremely fragmented, comprised of over 110,000 builders -- the majority of whom produce less than 25 units each annually. By contrast, the relatively young mobile home industry is made up of less than 400 companies and an unknown number of very small producers, and is fairly well concentrated within a small number of firms which account for a large proportion of total production. There are few barriers to entry in the traditional homebuilding field. In contrast, entry is more difficult in mobile home manufacturing where long-term capital investment is required for all but the smallest operators.

In recent years, it is fair to say that these differences between conventional homebuilding and mobile home manufacturing have begun to erode somewhat. The increasing use of prefabrication and other forms of industrialization, for example, have begun to move major elements

of homebuilding into the factory, where most mobile homes have always been produced. Moreover, a growing amount of concentration and diversification by both sectors of the industry has led to a situation where a fair number (about 20 or 50) of the largest corporations are involved in both traditional homebuilding and mobile home manufacturing. Although trends such as these appear to be blurring the distinctions between the two industry sectors to some extent, the differences are still greater than any similarities.

In 1972, the traditional homebuilding sector started 2,378,500 housing units while completions, a better measure of production performance, reached 1,999,200 units, up 47 percent from the 1,360,500 units completed in 1968. Completions of privately owned single-family units totalled 1,143,300 in 1972, a rise of 33 percent from 1968's 858,600 units. Privately owned multifamily unit completions increased at a far greater rate; the completion of 828,200 units in structures with two or more units represented an 80 percent increase over the 461,200 multifamily units completed in 1968.¹ Meanwhile during 1972, the mobile home manufacturing sector produced and shipped 575,940 mobile home units to dealers and land developers, including over 85,000 double-wide units (another 25,000 units were produced to house disaster victims and provide shelter to meet other special needs). The basic mobile home output was an increase of more than 80 percent over the 317,950 units shipped in 1968.²

While data is not available on the length of time which elapses between shipment of mobile homes by manufacturers, and sale and placement on site by dealers, there is evidence that it now takes longer to complete a conventional housing unit than was formerly the case. In 1968, a single-family unit needed, on the average, 4.3 months after construction start to be completed. In 1971, the average time necessary was 4.8 months, and in 1972, the period had increased to 5.2 months. Construction time for multifamily buildings exhibited similar increases; an apartment building with 10 to 24 units required an average construction time of 7.3 months in the period 1963 to 1967, 8.5 months in 1971 and

¹Department of Commerce, Bureau of the Census, Construction Reports, C22-73-5.

²Mobile Home Manufacturers Association, Mobile Home Shipments and Production, 1972 Annual Report.

9.3 months in 1972.³ Some of the recent lengthening of the construction process has been due to spot shortages of certain materials or craft skills. Materials and parts substitutions, and industrialization of the construction process offer some solutions to many of these problems, and should help to achieve a balance between industry capacity and the expanded demand for housing production.

STRUCTURE OF THE TRADITIONAL HOMEBUILDING SECTOR

During 1972, the U.S. homebuilding industry produced almost \$45 billion of new residential construction, making it one of the largest and most important segments of the domestic economy. Yet, unlike other industries of comparable size such as steel or automobiles, the homebuilding industry is characterized by many small firms with relatively short existences. Housing demand and production are highly cyclical due largely to fluctuations in the supply of mortgage credit, while equity capital requirements are minimal compared to other industries. As a result firms move in and out of the industry with great frequency, and it is difficult to determine precisely the number of housing producers that are operating at any given time. It is estimated⁴ that, as of 1967, roughly 110,000 homebuilding firms were in operation. In spite of the ease of entry, however, minority-owned construction firms continue to be quite rare.

The transitory nature of many of these homebuilding firms is evidenced by the fact that in 1967, about one-third did not have a payroll. The backbone of the industry consists of individual craftsmen, real estate operators and other small entrepreneurs who may build housing during periods of plentiful mortgage credit and turn to other activities during periods of tight money (See Chapter 3). Other features that characterize the bulk of homebuilders operating in the U.S. are:

EMPHASIS ON SINGLE-FAMILY DWELLINGS: Builders responses to a 1969 National Association of Homebuilders' survey indicated that less than 10 percent of those surveyed considered

³Department of Commerce, Bureau of the Census, Construction Reports, C30-70-1 Supplement; C20-72-7; C20-73-6.

⁴Based on The 1967 Census of Construction Industries, Department of Commerce, Bureau of the Census.

multifamily building their primary product. Homebuilders with unit production of less than 100 units were more likely to indicate custom homes or single-family homes to be sold on the speculative or open market as their primary products. On the other hand, larger producers (more than 100 units) were likely to be engaged in multifamily and/or speculative single-family building. (See Table 1)

FLEXIBLE BUSINESS STRATEGIES: Many homebuilders tend to "switch businesses" according to perceived market demands and/or the supply of money. They will also often engage simultaneously in the related businesses of speculative building, custom building, rehabilitation and remodeling, land development, and commercial and industrial construction. This has enabled many to survive financially when the residential housing market declines, thereby giving them the resilience to re-enter that market when conditions improve.

HIGH INCIDENCE OF SUBCONTRACTING: According to the 1969 National Association of Home Builders survey, nearly 90 percent of the homebuilders surveyed subcontract at least 25 percent of their costs of construction. (Chart 1)

INCREASING PROPORTION OF SOLE PROPRIETORSHIPS: According to the same 1969 National Association of Home Builders survey, about 37 percent of U.S. homebuilders are organized as sole proprietorships and 45 percent as corporations, with the remainder being partnerships or a combination of forms. However, when the 1969 figures are compared with the National Association of Home Builders 1964 survey, the proportion of builders organized as sole proprietorships had risen from 30 to almost 37 percent in five years. (Chart 2) Sole proprietorships are particularly prevalent among single-family builders and producers of one to 25 units. These builders are the most likely to remain a short time in the industry and, therefore, the most likely to opt for a simple and inexpensive mode of entry. Conversely, among producers of more than 100 units annually, the corporate form of organization is most common, reflecting the need for greater financial resources and the limited liability features of incorporation. (Chart 3)

THE LARGE HOMEBUILDERS

While not much further detailed information is available on the industry as a whole, considerably more can be said about the few large homebuilders at the top of the industry -- i.e., those companies that either have annual sales of over \$10 million or annual volume of over 200

TABLE 1

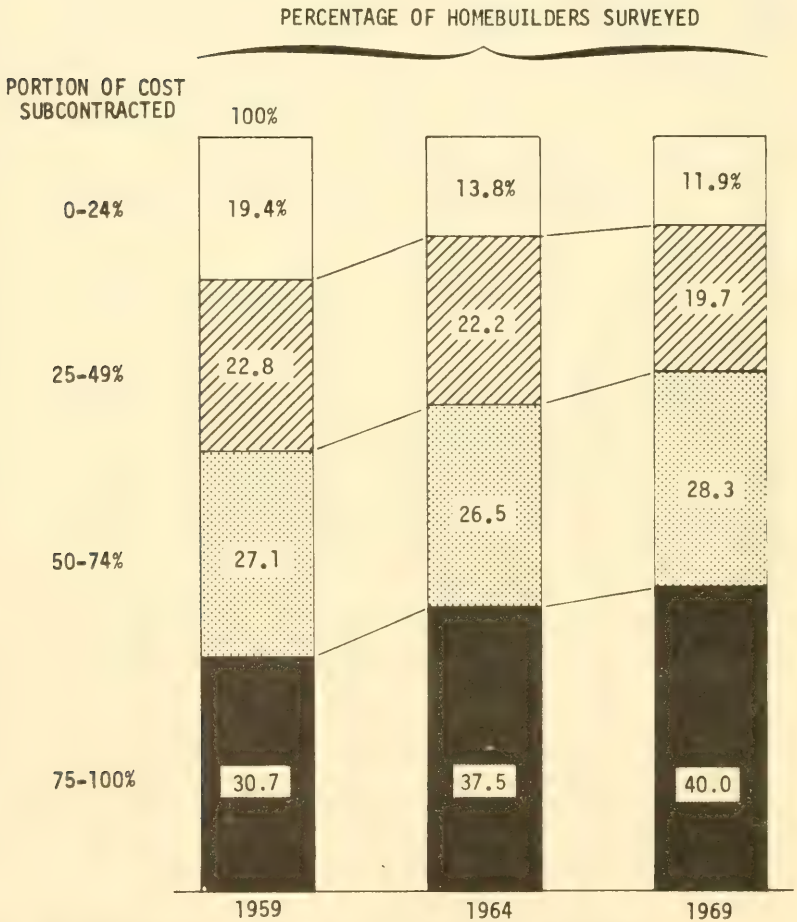
PERCENTAGE OF FIRMS OR OPERATORS BY CATEGORY

PRIMARY PRODUCT OPERATION	TOTAL 1969 SURVEY	BUILDERS SURVEYED		
		SMALL (1-25 UNITS)	MEDIUM (26-100 UNITS)	LARGE (101+ UNITS)
SPECULATIVE SINGLE FAMILY	20.4%	19.8%	33.0%	34.7%
CUSTOM SINGLE FAMILY	19.0	28.8	13.8	4.2
MULTIFAMILY	9.3	4.8	13.5	31.7
NOT CLASSIFIED ABOVE	51.3	46.6	39.7	29.4

SOURCE: NATIONAL ASSOCIATION OF HOMEBUILDERS, PROFILE OF THE BUILDER AND HIS INDUSTRY, 1969.

CHART 1

THE IMPORTANCE OF SUBCONTRACTING BY BUILDERS

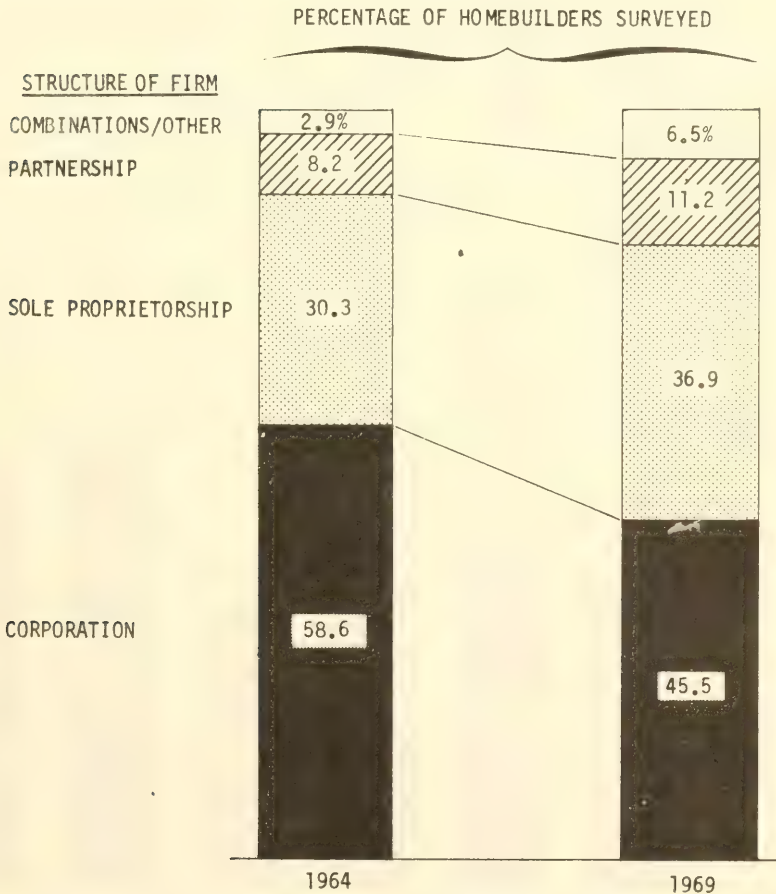


NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING.

SOURCE: NATIONAL ASSOCIATION OF HOMEBUILDERS, PROFILE OF THE BUILDER AND HIS INDUSTRY, 1969.

CHART 2

ORGANIZATION OF THE HOMEBUILDING INDUSTRY



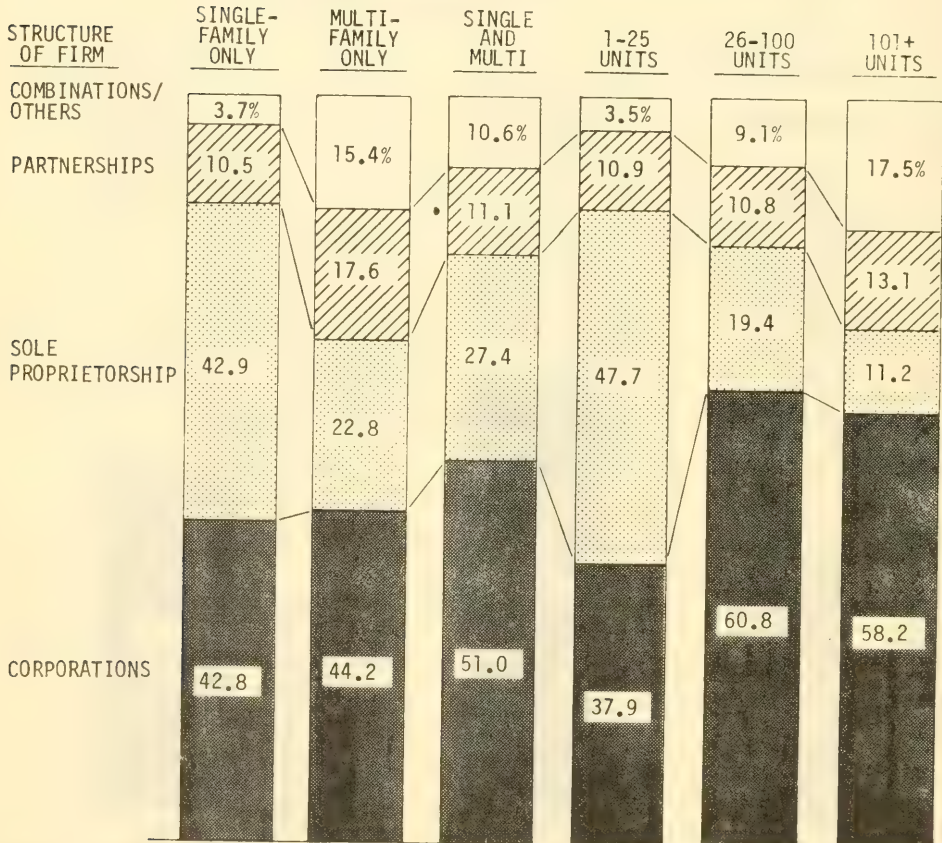
NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING.

SOURCE: NATIONAL ASSOCIATION OF HOMEBUILDERS, PROFILE OF THE BUILDER AND HIS INDUSTRY, 1969.

CHART 3

STRUCTURE OF FIRMS BY TYPE AND VOLUME OF PRODUCTION

PERCENTAGE BY TYPE AND SIZE OF OPERATION



NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING .

SOURCE: NATIONAL ASSOCIATION OF HOMEBUILDERS, PROFILE OF THE BUILDER AND HIS INDUSTRY, 1969.

units. Overall, it appears that these firms, which represent less than one percent of the firms in the home-building sector, tend to be comparatively stable, relatively well-capitalized corporations. They are characterized by:

1. An increasing share of the market -- 28 percent of 1972 housing production and 23.5 percent of dollar revenues in that year,
2. A high level of acquisition and merger activity, and
3. Uneven financial performance.

However, despite their similarities, these large firms show distinct differences in terms of geographic span of operations, the incidence of public ownership, organizational structure and other operating characteristics. The following sections discuss these key similarities and differences. It is important to emphasize, however, that these large homebuilders are the exception rather than the rule in this industry: small homebuilders producing less than 200 units a year remain the dominant force representing over two-thirds of the market.

AN INCREASING SHARE OF THE MARKET: According to an annual survey prepared by Professional Builder, the number of homebuilders with greater than \$10 million in annual sales grew from 119 in 1968 to 369 in 1972.⁵ Observing the emergence of large homebuilding firms from another point of view, the 1973 Bluebook of Major Homebuilders reports that the 511 builders with annual volume of more than 200 units have captured an increasing share of the market over the last few years. As shown in Chart 4, the unit volume of these builders represented 17.2 percent of total housing production in 1969. By the end of 1972, this share had increased to 28 percent. Moreover, about three-quarters of this 1972 share is attributable to the 225 firms with volume of more than 1,000 units annually. In terms of dollar volume, the value of housing constructed or manufactured by the largest homebuilders has increased steadily as shown below:

⁵The sales figures also include nonhousing-produced revenue. In addition, these are not constant dollars and therefore some portion of the firms entered the "giant" category solely by virtue of inflation.

DOLLAR VOLUME OF HOUSING "GIANTS"
(Housing Revenues)

Year	Volume (Millions of Dollars)
1968	\$2,670
1969	5,356
1970	6,833
1971	9,132

Source: Professional Builder magazine, July issues, 1969 to 1972, which defines "Giants" as those homebuilders with sales greater than \$10 million annually.

However, although major homebuilders continue to increase total dollar volume and to capture a growing share of the total number of units produced, in 1972 their share of the industry's total dollar volume decreased. (Chart 5)⁶ Because small builders are more susceptible to cyclical factors, during housing recessions their volume declines more than that of the major homebuilders. The larger firms sometimes even maintain or increase their dollar volume in the face of recession, thus increasing their share of the market. In housing booms, the reverse occurs. Small builders grow faster than large builders, thus reducing the market share of the latter.

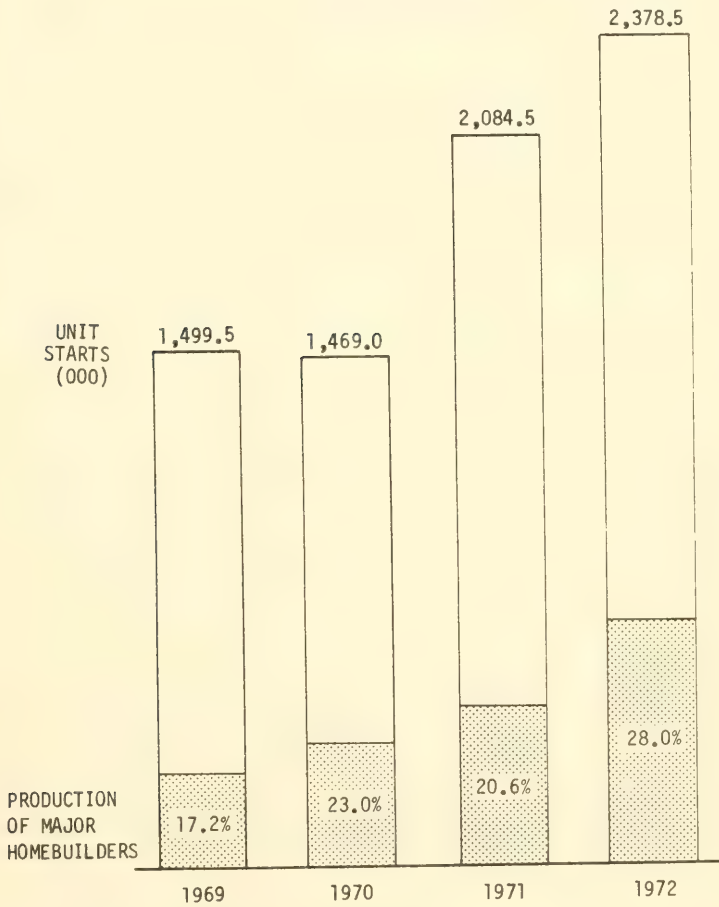
HIGH LEVEL OF MERGERS AND ACQUISITIONS: A high level of merger and acquisition activity has been associated with recent industry concentration, at least on the part of the publicly held homebuilders, whose activities are recorded. However, industry observers feel that this trend is also occurring among most large homebuilders -- whether or not they are publicly held -- and has been continuously occurring over time throughout the industry.

Between 1969 and 1972, 31 publicly held homebuilders with annual revenues exceeding \$25 million engaged in a total of 84 mergers or acquisitions. This level of merger activity

⁶Chart 5 uses value put in place as a measure of total dollar volume. However, the sales of "giant" homebuilders (defined by Professional Builder as those homebuilders with annual sales in excess of \$10 million), which is used to determine market share, includes land sales. Therefore, the estimate of the share of "giant" homebuilders is somewhat overstated.

CHART 4

MARKET SHARE OF MAJOR HOMEBUILDERS

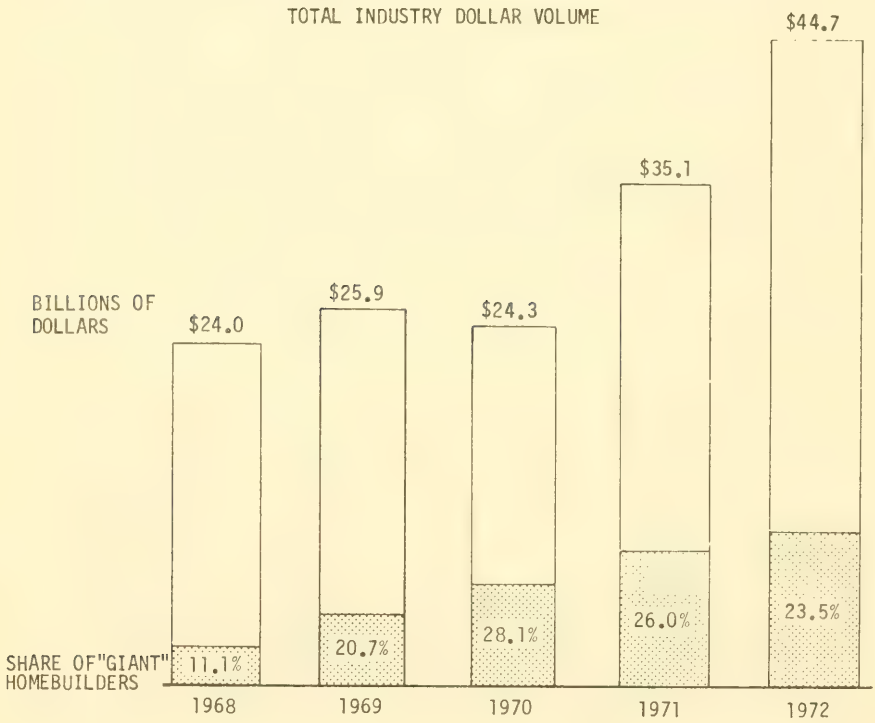


NOTE: DATA EXCLUDE MOBILE HOME PRODUCTION .

SOURCE: DEPARTMENT OF COMMERCE, CONSTRUCTION REPORTS, C20-73-3; CMR ASSOCIATES, INC., BLUEBOOKS OF MAJOR HOMEBUILDERS, 1970 - 1973.

CHART 5

DOLLAR VOLUME AND MARKET SHARE OF "GIANT" HOMEBUILDERS



SOURCE: DEPARTMENT OF COMMERCE, CONSTRUCTION REPORTS, C30-73-6; PROFESSIONAL BUILDER MAGAZINE, JULY ISSUES 1969 - 1973.

is extremely high compared to other industries. Among the top 200 manufacturing and mining firms, for example, the average number of mergers/acquisition per company was 0.17 per year during the same period. By contrast, the average for the 31 publicly held homebuilders was 0.68 per year -- about four times as many. Although this comparison is not a totally fair one, due to the obvious differences between construction and manufacturing, it does provide some insight into current merger and acquisition activity in the industry.

Major homebuilders have been merging with and acquiring other firms for three principal purposes. First, they may wish to diversify into broader product lines. In response to the high unit cost of and diminishing growth in single-family detached housing, for example, a single-family homebuilder might acquire firms with capability to construct garden apartments, mobile homes or townhouses. Of the identified mergers and acquisitions made by the 31 large publicly held homebuilders, 43 percent were actions that provided such product line diversification.

Geographic expansion is another important motivation behind merger and acquisition activity, representing about 32 percent of the mergers/acquisitions identified. Geographic expansion provides the benefit of shielding the builder from the possibility of serious dislocations in a single market area. Many large firms undertake geographic expansion through acquisition of existing builders in order to profit by the established builder's reputation and relationship with local governments and building officials. The importance of quickly gaining an understanding of local market preferences, suppliers, and sources of labor subcontractor capability is obvious. The diversity of local building codes is also a key force behind acquisition of this kind.

Finally, vertical integration has accounted for 25 percent of the mergers and acquisitions identified. Such integration generally has taken the form of combinations with building supply organizations, housing fabricators, land development enterprises and financial institutions.

Despite this high level of merger/acquisition activity, economic concentration of homebuilding is still relatively low, with the largest homebuilding firm accounting for less than six tenths of one percent of the Nation's total conventional housing production.

UNEVEN FINANCIAL PERFORMANCE: Assessing the financial performance of the traditional homebuilding industry is extremely difficult. Any generalizations made about this area must be particularly guarded. Because of the fragmented nature of the industry, no meaningful financial statistics have been collected on a comparative basis for the bulk of U.S. homebuilders, which are proprietorships, partnerships, and closely held private corporations. Moreover, even among publicly held corporations and subsidiaries that must provide public financial statements, non-homebuilding activities undertaken by these corporations are pooled with or incorporated into the financial results for homebuilding activities. The situation is further complicated by the fact that the accounting profession is currently redefining some important principles that apply to homebuilders. As a result, year-to-year comparisons may be somewhat inconsistent and misleading.

However, despite these constraints, an analysis of the financial performance of 11 large, publicly held homebuilders with relatively uncomplicated income statements provides some insights into the financial structure and profitability of at least the largest participants in the industry. Average historical financial data for these firms in the years 1969 through 1972 are presented in Table 2.⁷

Financial Leverage: Financial leverage is defined as a firm's ability to augment its own equity with the financial resources of others -- e.g., through issuing long-term debt and drawing on lines of credit.

There is a wide variance in the extent to which different firms use equity to finance asset holdings. Moreover, equity as a percent of assets varies significantly from year-to-year in a single firm. For the average of all firms represented in the charts, the equity-asset ratio is higher in 1971 and 1972 than in 1969 and 1970, but the period studied is too short to establish a reliable trend.

Profit Margins: A major factor affecting return on investment is profit margin, or return on sales. Although many individual companies have experienced shifts in profit

⁷Averages used are unweighted; because of this and the variations in non-available data, the averages are only approximate indicators of the performance of this particular class of homebuilders.

TABLE 2

AVERAGE FINANCIAL PERFORMANCE OF SELECTED MAJOR HOMEBUILDERS

YEAR	RETURN ON EQUITY	RETURN ON ASSETS	GROSS MARGIN	RETURN ON SALES	EQUITY AS A PERCENTAGE OF ASSETS	SALES/ASSETS
1972	23.8%	7.8%	20.3%	5.6%	41.3%	1.094
1971	31.8%	10.0%	19.7%	5.7%	37.5%	1.072
1970	33.8%	7.1%	19.3%	5.3%	31.8%	1.057
1969	17.5%	7.2%	19.0%	4.8%	35.7%	1.490

margins, average return on sales has not varied markedly for these selected companies over the past four years -- i.e., from 4.8 percent in 1969 to 5.6 percent in 1972.

Velocity of Asset Utilization: Another component of the profit mechanism is the velocity of asset utilization, or the dollar volume of sales as a multiple of total assets employed. The basic rule applied is that the more effectively assets are utilized (or turned over) to make a profit, the lighter the burden of their fixed costs -- i.e., interest and dividends. Asset velocity appears to have declined from the 1969 high, perhaps as a result of the increased size of these 11 large, publicly held builders.

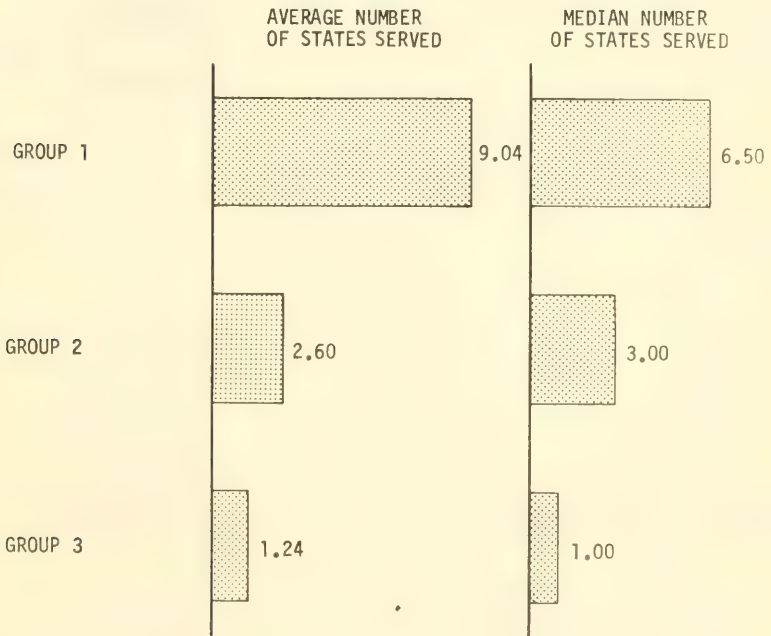
KEY DIFFERENCES IN OPERATING CHARACTERISTICS: Although it can be assumed that the major homebuilders are different from the remaining thousands of small builders, important operating differences exist even among the approximately 500 firms that produced more than 200 units in 1972. To highlight these differences, a recent independent study conducted for HUD examined the 511 homebuilders identified by the "Bluebook of Major Homebuilders" in three groups: (A) the top 25 homebuilders in unit volume (Group 1); (B) a sample⁸ of builders ranking from 26 to 200 inclusive in unit volume on the "Bluebook's" list (Group 2); and (C) an equal sample of builders whose unit volume places them between 200 and 500 on the list (Group 3). In analyzing the differences among these three segments, quite significant variations were found in terms of:

Geographical Span of Operations: As Chart 6 indicates Group 1 builders operate in an average of nine States, while Group 2 firms typically operate in less than three States, and Group 3 firms primarily in one State only. However, it should be noted that all Census-defined regions of the country have experienced growth in the number of major homebuilders. (Chart 7) Further, only the top 25 builders are multi-regional. While six of these builders are known to operate on a nationwide basis, the average number of regions served is between two and three. Although operating data are not available on the smallest builders (i.e., those with annual volume of less than 200 units), one could conclude that the vast majority operate in only one marketing area. Thus, given that the smallest homebuilders represent more than 99 percent of all homebuilding firms, the industry is primarily a "local" business.

⁸The sample size equaled 25.

CHART 6

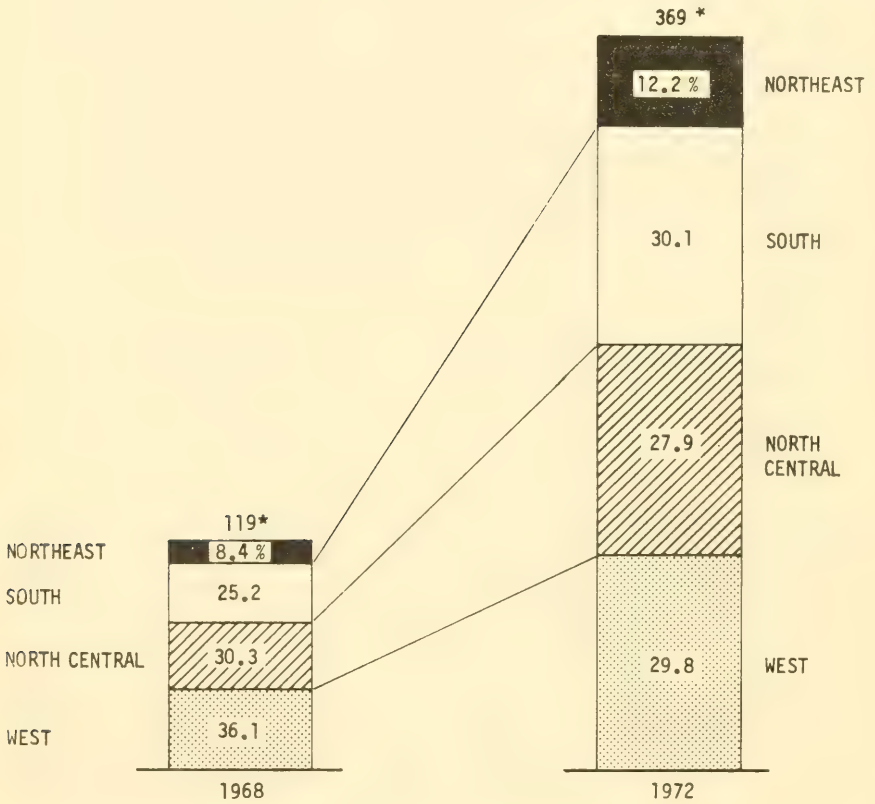
THE RELATIONSHIP BETWEEN THE SIZE OF THE HOMEBUILDER
AND THE NUMBER OF STATES SERVED



SOURCE: CMR ASSOCIATES, INC., THE BLUEBOOK OF MAJOR HOMEBUILDERS, 1973.

CHART 7

THE REGIONAL CONCENTRATION OF MAJOR HOMEBUILDERS



NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING.

* NUMBER OF HEADQUARTERS.

SOURCE: PROFESSIONAL BUILDER MAGAZINE, JULY 1973, P.107.

Ownership: As might be expected, the larger the homebuilding firm the more likely it is to be publicly held. (Chart 8) Over half of the top 25 are publicly held, while only 24 percent of the Group 2 and 20 percent of the Group 3 are publicly held. Although the transformation into public entities has provided these companies with a more stable source of capital, many have experienced severe personnel turnover problems. The bulk of homebuilding enterprises begin as "one-man" entrepreneurial operations and usually continue as such as they grow. Even the largest operations are today heavily dependent upon the personal style and leadership of "one-man" or are a confederation of "one-man" entities. When a chief executive becomes responsible to shareholders rather than himself, the situation changes considerably. For one, the entrepreneurial rewards formerly available as the result of profitable "deals" are replaced by more standard salary, bonus, and fringe benefit packages. A further complication occurs when a public organization unfamiliar with homebuilding operating styles acquires a homebuilder. In such cases, the chief executive is compelled to adapt to corporate procedures that may or may not be appropriate to housing production. As a result executive turnover among publicly held homebuilders acquired by publicly held corporations has been high.⁹ Of 14 recently acquired homebuilders, for example, only four of the acquired chief executives are still with their companies.

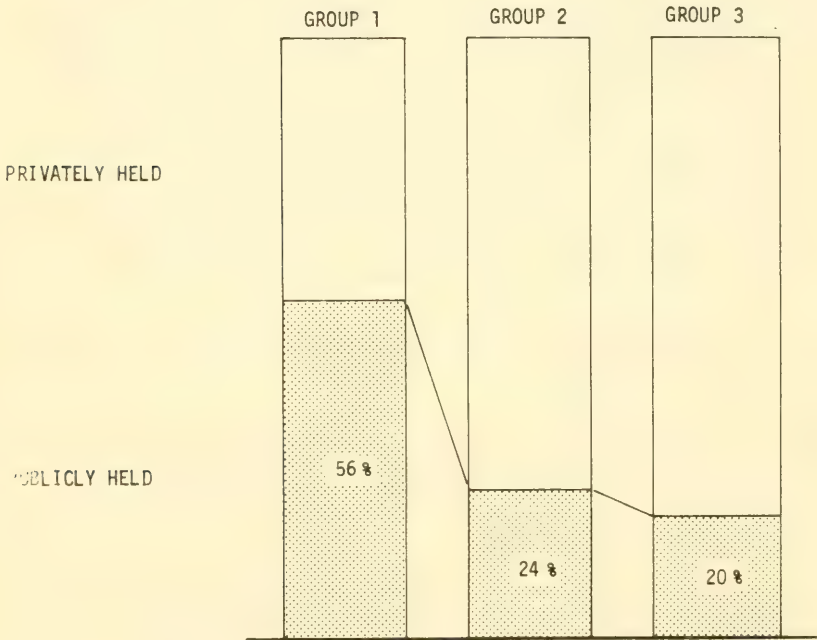
Internal Organization: Among the large homebuilders four distinct types of internal organization are typically employed:

Decentralized Management - Group 1 firms and some Group 2 firms typically adopt a regionalized organizational structure and delegate a large share of responsibility to the field. The field organization is supported by an operating staff at the regional level for finance, market-

⁹ A survey of the Nation's largest homebuilders that was recently conducted by the management consulting firm, McKinsey & Company, Inc., reported that the upper third of those homebuilders experiencing turnover realized an average annual loss of 35 percent of their middle managers. Another recent McKinsey study of the activities of insurance companies in real estate development operations reported "high turnover" among top, middle, and project managers.

CHART 8

INCIDENCE OF PUBLIC OWNERSHIP BY SIZE OF BUILDER



SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY," A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, USING DATA FROM CMR ASSOCIATES, INC., THE BLUEBOOK OF MAJOR HOMEBUILDERS, 1973; AND STANDARD AND POOR'S.

ing, engineering, and construction. Headquarters executives review major decisions in terms of performance against plan, and are supported by a specialized budgeting and planning staff.

Coalition - Some Group 1 firms and the larger Group 2 enterprises employ a "coalition" form of organizational structure. This semi-centralized form of organization essentially replicates small- to medium-sized building companies in each of the regions in which the firms operate, with a small central staff devoted primarily to financial management.

Centralized Management - Typical of the small Group 2 and larger Group 3 firms is a highly centralized structure that attempts to use management processes to reinforce the effectiveness of the organization's key decision maker -- usually the founding entrepreneur. This form of management places a very lean project management team in the field at each project and centralizes all other staff, so that top management has access to them and can review all major operating decisions.

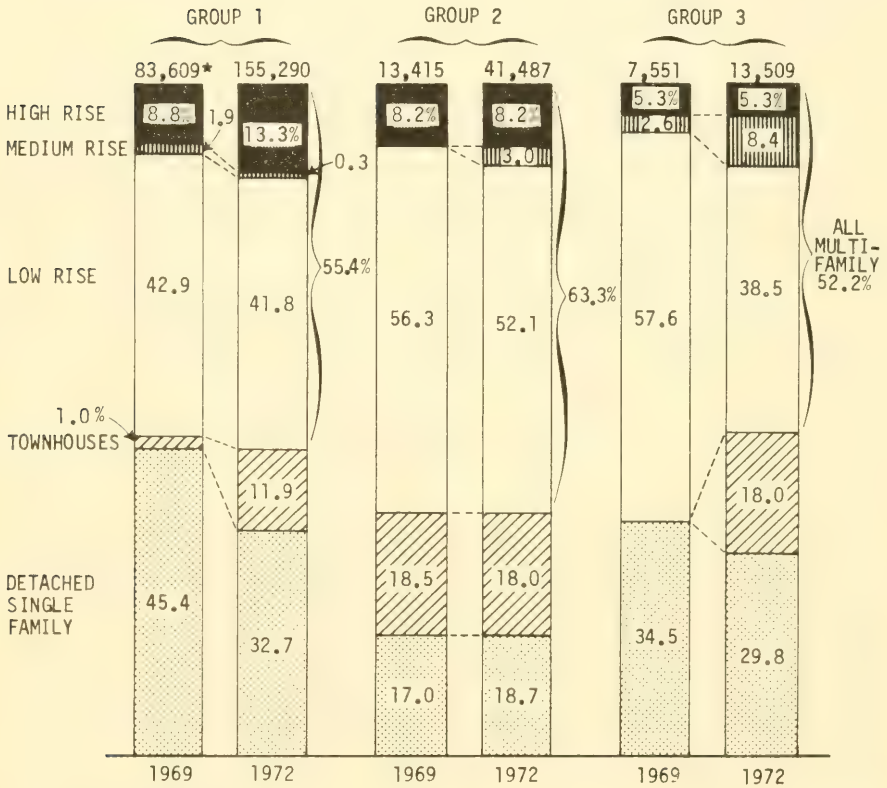
"One-Man" Management - The bulk of Group 3 and smaller entities employ a highly centralized form of management in which their chief executives (and close associates or members of their families) make all the operating decisions. In such cases, the small central staff spends much of its time on-site, and part-time specialists are employed on a project basis for accounting, financial management, design and engineering, and legal matters.

TYPE OF DWELLINGS BUILT: In terms of product lines, there appear to be no dramatic differences among the three groups of large homebuilders (Chart 9). Unlike the majority of homebuilders, the largest firms in the industry produce relatively more multifamily units than single-family, with the major share of the volume being derived from low-rise apartments. However, while the product mix of Group 2 builders has not changed significantly from 1969 to 1972, the top 25 builders have been diversifying out of single-family detached production into townhouses and highrises. Similarly, Group 3 firms have also been diversifying into townhouses.

THE USE OF INDUSTRIALLY PRODUCED PARTS: As might be expected, Group 1 homebuilders use major premanufactured parts more extensively than Group 2 or 3 firms. (Chart 10) Of the top 25 builders, 60 percent report using industrially produced parts and components in 52 percent of their

CHART 9

PRODUCT MIX BY SIZE OF BUILDER



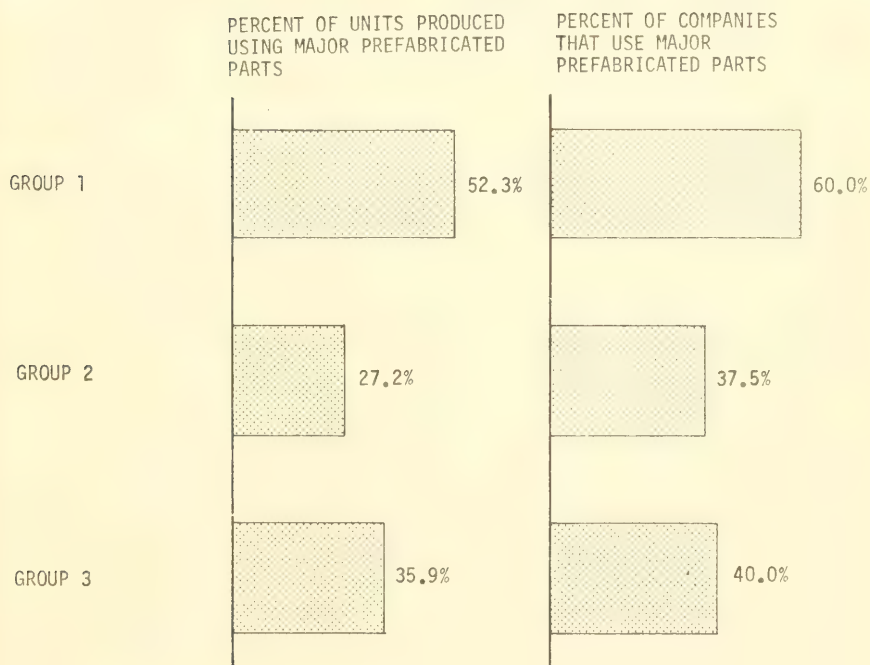
* VOLUME IN UNITS.

NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING.

SOURCE: CMR ASSOCIATES, INC., BLUEBOOKS OF MAJOR HOMEBUILDERS, 1970 AND 1973.

CHART 10

USE OF FABRICATED PARTS BY SIZE OF BUILDER



SOURCE: CMR ASSOCIATES, INC., THE BLUEBOOK OF MAJOR HOMEBUILDERS, 1973.

production. In many cases, these parts and components are manufactured in company-operated factories and then assembled on-site. Many executives of Group 1 firms anticipate a growing reliance on such methods of operation.

STRUCTURE OF THE MOBILE HOME MANUFACTURING SECTOR

Compared with the traditional homebuilding sector the mobile home manufacturing segment of the housing industry, is comprised of a relatively small number of firms -- fewer than 400,¹⁰ with most activity concentrated among a relatively few firms. In addition, mobile home manufacturers are generally well-capitalized organizations, utilizing production-line fabrication techniques and distributing through dealerships. Although on a slightly different scale, the mobile home manufacturing sector has shown the same type of trends, however, that can be seen within the high-production segment of the homebuilding industry -- i.e., increasing concentration, heavy merger/acquisition activity, and uneven financial performance.

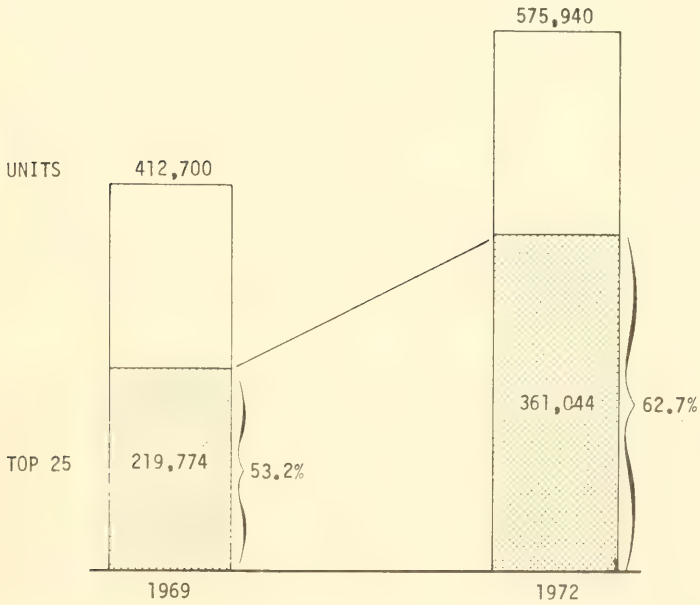
CONCENTRATION OF THE INDUSTRY: The Mobile Home Manufacturers Association recently estimated that about 335 mobile home manufacturers operate in the U.S., a number less than one-half of 1 percent of the number of firms engaged in traditional, on-site homebuilding. Among this relatively small number of companies, industry activity has become increasingly concentrated among the largest firms. The market share of the top 25 producers in terms of unit volume has grown from 53 percent to 63 percent during the period from 1969 to 1972. (Chart 11)

The reasons behind such concentration can be traced to the nature of the industry. To a far greater extent than is possible for on-site homebuilders, the operations of mobile home manufacturers lend themselves to economies of scale and other operating benefits achieved through increases in size. In an industry where the cost of purchased materials typically accounts for over 50 percent of the total cost per unit, purchasing control and quantity price agreements are particularly significant. One of the top mobile home manufacturers believes that its purchasing power and skill have been the key factors in maintaining high profitability in the face of escalating costs.

¹⁰This does not include an unknown number of very small operators who produce a few units per year.

CHART 11

MARKET SHARE OF THE TOP 25 MOBILE HOME MANUFACTURERS

SOURCE: AUTOMATION IN HOUSING MAGAZINE; MOBILE HOME MANUFACTURERS ASSOCIATION.

Although it cannot be determined whether such concentration will continue, most of the largest mobile home manufacturers have built extensive new facilities over the last few years and have ambitious expansion plans for the future. In 1972, for example, one of the top five producers added 10 new plants and anticipates adding another 10 each year for the next four years. Similarly, seven out of 32 companies with sales in excess of \$25 million added two or three plants each last year. While it is difficult to identify the type and amount of expansion that is occurring among the smaller, privately held companies, one can speculate that their rate of expansion is not as high due to comparatively limited capital resources.

HIGH LEVEL OF MERGER AND ACQUISITION ACTIVITY: The benefits of economies of scale, purchasing power and broad geographic penetration have been instrumental in spurring the high level of merger and acquisition activity that has occurred in this industry segment, particularly during the late 1960's and to a lesser extent thus far in the 1970's. (Chart 12) From 1969 to 1971, merger and acquisition activity in the mobile home manufacturing sector exceeded levels in the overall manufacturing and mining industries -- i.e., an annual rate of 0.47 mergers/acquisitions per company¹¹ compared to 0.17 for the 200 largest manufacturing and mining concerns. This level of activity is less than that in the traditional homebuilding industry, probably because the industry is smaller and already much more concentrated, thereby limiting the number of possible mobile home manufacturers that are candidates for merger and acquisition.

An analysis of mergers and acquisitions recorded by Standard and Poor's during the 10 year period of 1962 to 1972 shows that nearly 120 such actions involved mobile home concerns. (Chart 13) Of these, the largest number -- over 40 percent -- were horizontal combinations of mobile home manufacturers that led to production or purchasing economies of scale, and perhaps more importantly, geographic penetration. In order for a mobile home manufacturer to penetrate a new market, it must either build or acquire a plant in that locale. This is because the high cost of transporting mobile homes limits the profitable distribu-

¹¹McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a 1973 study prepared for the National Housing Policy Review, Department of Housing and Urban Development, using data for 35 of the largest, publicly held mobile home companies for which public informations is available.

CHART 12

ACQUISITION ACTIVITY IN THE MOBILE HOME INDUSTRY

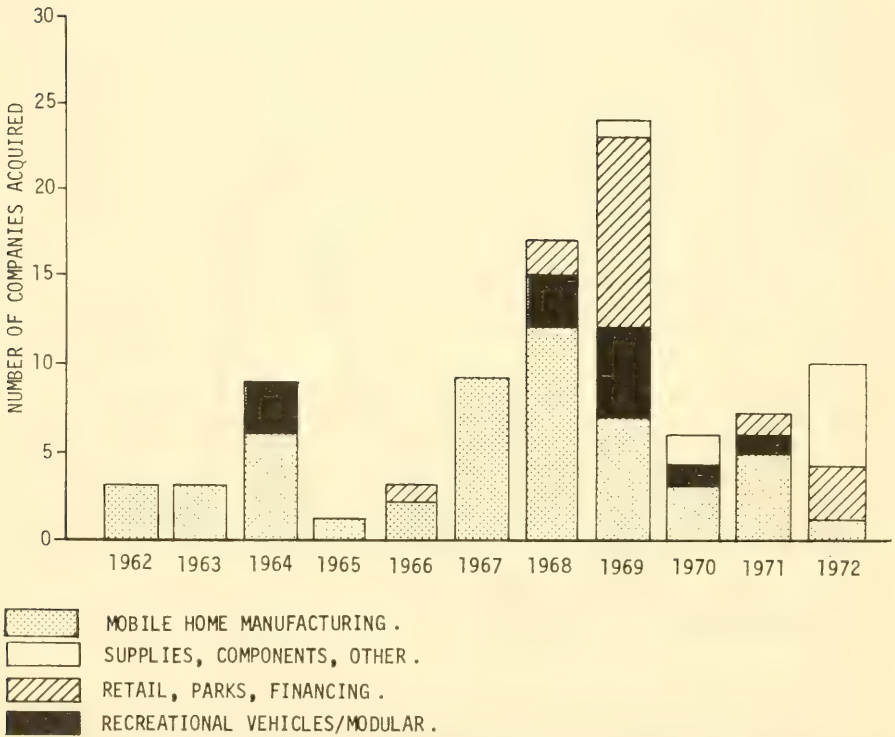
NUMBER OF
COMPANIES
ACQUIRED

TOTAL ACQUISITIONS BY 35 TOP INDUSTRY COMPANIES.

SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY,"
A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,
NATIONAL HOUSING POLICY REVIEW, USING DATA FROM STANDARD AND POOR'S.

CHART 13

PRINCIPAL PRODUCTION ACTIVITY OF FIRMS ACQUIRED BY MOBILE HOME MANUFACTURERS



SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY," A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, USING DATA FROM STANDARD AND POOR'S AND 21 MOBILE HOME MANUFACTURERS.

tion in most cases to within 300 to 500 miles of the manufacturing facility.¹²

While the great bulk of mergers and acquisitions over the last decade have been within the industry itself, 23 percent of the actions identified have been recent acquisitions by large diversified corporations seeking a share of the industry's growth in sales and earnings. In such cases, large publicly-held corporations have acquired some of the highest volume producers in the industry. Three of the top 10 mobile home manufacturers, which together accounted for more than \$300 million in sales in 1972, have become subsidiaries of large, diversified corporations in the last few years.

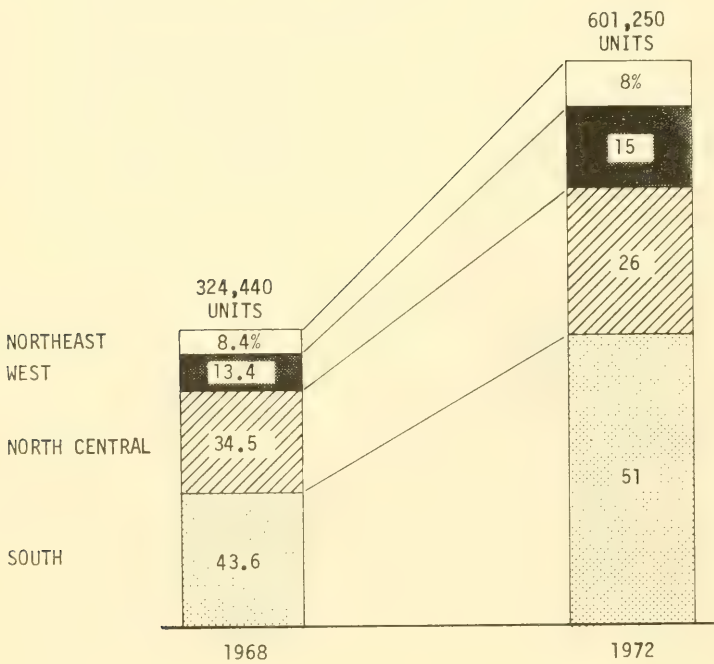
MAJOR OPERATING CHARACTERISTICS: While the production of mobile homes is somewhat concentrated, the distribution and retailing system is not. Most mobile home manufacturers distribute their homes through an estimated 10,500 non-exclusive mobile home dealers, although some mobile home manufacturers have diversified into retailing themselves. The independent retail outlets are generally small, with typical annual sales of less than \$500,000 and they almost always carry competing brands of products. Other key operating characteristics of mobile home manufacturers are as follows:

Geographic Concentration: Because the high cost of transporting mobile homes limits markets geographically, State and regionally based businesses are the norm in the mobile home industry. As a result, many small manufacturers have been able to survive in their locales despite the presence of large manufacturers in the industry. Only the top five producers, for example, operate on a nationwide basis, having from 24 to 56 plants each. The remaining top 25 manufacturers tend to distribute in one or two census regions, operating from four to nine plants. The geographic limitations on production and distribution have also led to concentration of producers in those areas where consumer demand is highest. As Chart 14 shows, between 1968 and 1972 mobile home output became even more concentrated in the South, where the retirement and non-urban, blue collar markets are particularly strong. In turn, production in the North Central States, the other traditional market area, has declined somewhat.

¹²Ibid. The transportation costs of mobile homes range from 60 cents to 90 cents per mile.

CHART 14

REGIONAL CONCENTRATION OF MOBILE HOME PLANT OUTPUT



NOTE: PERCENTAGES MAY NOT ADD TO 100.0 BECAUSE OF ROUNDING.

SOURCE: MOBILE HOME MANUFACTURERS ASSOCIATION.

Ownership: In conjunction with merger and acquisition activity on the part of larger firms, the degree of public ownership has increased substantially over the past several years. Of large mobile home manufacturers¹³ over 90 percent are publicly held (or parts of publicly held enterprises) compared with 64.5 percent in 1969. (Chart 15)

Financial Performance: As is the case for homebuilders, financial data are only available for the large, publicly held mobile home manufacturers. An analysis of 10 of the largest firms whose principal business is mobile home manufacturing shows an uneven performance over the past four years as evidenced by fluctuations in profit margins, leverage, and asset velocity (Table 3).¹⁴

Profit margins (return on sales), an important variable in this production line industry, have varied from 3.95 percent in 1969 to a low of 3.3 percent in 1972, with intervening fluctuations in 1971 and in 1970. In general, return on equity (profitability) has been highest in those years with highest return on sales. For example, in 1969 and 1971 when profit margins were highest (i.e., 3.95 percent and 3.8 percent), return on equity was most attractive (i.e., 33.9 percent and 35.8 percent). Conversely, 1972, the year of poorest aggregate performance (20.3 percent return on equity) also was a year of low profit margins (3.3 percent). In this high volume industry, it should be noted that profit margins are not nearly so high as in traditional homebuilding, where return on sales typically runs 5 to 6 percent for the largest homebuilders.

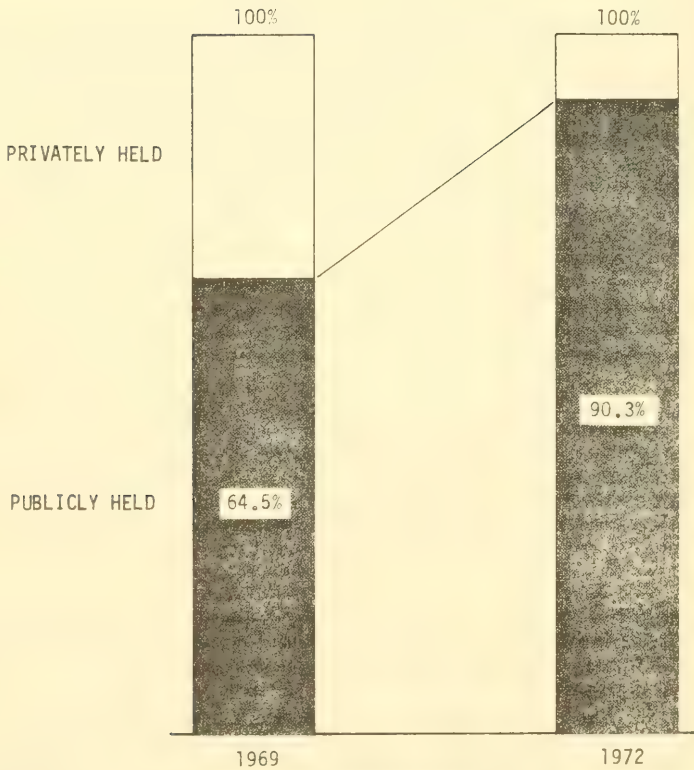
Financial leverage has also shown an uneven pattern. Equity as a percent of assets has been at about 54 percent for 1969 and 1972, but significantly higher for 1970 and 1971. As might be expected from the differences in their operations, mobile home manufactures have a higher degree of equity financing than major homebuilders, whose equity as a percent of assets averages from 30 to 47 percent.

¹³Ibid. The 32 mobile home manufacturers with 1972 sales exceeding \$20 million, of which at least 50 percent was derived from the manufacture of mobile homes.

¹⁴Averages used are unweighted; because of this and variations in non-available data, the averages are only approximate indicators of the performance of this particular class of mobile home manufacturers.

CHART 15

THE AMOUNT OF PUBLIC OWNERSHIP
OF MOBILE HOME MANUFACTURERS



SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY," A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, USING DATA FROM 32 PUBLICLY HELD MOBILE HOME MANUFACTURERS.

TABLE 3

AVERAGE FINANCIAL PERFORMANCE OF SELECTED MAJOR MOBILE HOME MANUFACTURERS

YEAR	RETURN ON EQUITY	RETURN ON ASSETS	GROSS MARGIN	RETURN ON SALES	EQUITY AS A PERCENTAGE OF ASSETS	SALES/ASSETS
1972	20.3%	12.0%	13.7%	3.3%	54.4%	2.779
1971	35.8%	21.5%	15.2%	3.8%	57.2%	3.080
1970	26.4%	15.7%	15.1%	3.58%	59.6%	3.220
1969	33.9%	16.9%	NA	3.95%	54.2%	4.612

NA: NOT AVAILABLE.

SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY," A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, USING DATA FROM PROFESSIONAL BUILDER MAGAZINE, JULY 1970 - 1973.

One distinct trend among large, publicly held mobile home manufacturers has been a decreasing level of asset velocity. Aggregate sales to asset ratios have decreased from 4.6 in 1969 to 2.8 in 1972. Although asset turnover is decreasing dramatically (probably as a result of increased size), it is important to note that it still exceeds traditional homebuilder velocity by a factor of two.

In sum, traditional on-site homebuilding and mobile home manufacturing are now sharply distinct sectors of the housing industry. As seen, the traditional sector is extremely fragmented, deriving its production primarily from thousands of small custom and speculative builders, many of which enter and exit the market as dictated by market conditions. In contrast, the mobile home sector is essentially a manufacturing, assembly line business involving a relatively small number of manufacturers. However, as mentioned at the outset, the lines between these two sectors are beginning to blur to some extent. As will be described in the next section, some of this slight convergence can be traced to the increased industrialization of the industry and advances in technology that have enabled homebuilders to realize the economies of factory-produced housing hitherto available only to mobile home manufacturers.

THE STATE OF HOUSING TECHNOLOGY

In the housing industry, the concept of technological advances as radical shifts in methodology does not readily apply. Changes in this industry have been gradual -- evolutionary as opposed to revolutionary.

Rapid change in housing technology is inhibited in part by the inability to test or "prove" new ideas easily. There is great reluctance on the part of builders and housing manufacturers to experiment with new products and techniques, since innovations are perceived to be risky under many market conditions. Another reason for the relatively slow growth in housing technology is the existence of a vast number of divergent and restrictive State and local building codes (See Chapter 5). These codes usually specify hundreds of different construction requirements. Another effect has been to fragment and thus limit the size of particular housing markets, making mass production more difficult. The cyclical nature of the housing industry also inhibits the rate of technical progress because it limits the willingness of producers to adopt the capital-intensive production techniques that are often necessary to make new products economical.¹⁵

Despite these and other constraints, there have been some significant changes in the way in which a house is built, particularly when viewed over a longer period of time. Sectional and modular housing, for example, were relatively unheard of prior to the sixties. Although mobile homes have been in existence for over 40 years, the speed at which they can be produced has increased very rapidly in recent years, due to the introduction of and refinements in assembly line techniques. In addition to these advances, the housing industry has also experimented with new applications of materials -- e.g., plastics, fiberglass, and epoxy.

PRODUCTION TECHNOLOGY

Industrialization in housing involves the application by housing producers of such industrial methods as advances in production techniques, equipment, and organization and management. The introduction of industrially produced

¹⁵For an analysis of these problems, see "An Historical Evaluation of Industrialized Housing and Building Systems in the United States," prepared for the Report of the Presidents Committee on Urban Housing, Vol. II, Washington, D.C.: Government Printing Office, 1968, pp. 181-189.

components into the on-site production of housing is one important element in the industrialization process. The use of these products has been evolutionary, beginning with small elements and progressing to larger, more complex components. Examples of these manufactured items include electrical parts, windows, kitchen cabinets, prehung doors, roof trusses, utility cores, and exterior wall units.

The most visible changes in construction techniques and methodologies are to be seen in the growing rate of factory production of complete housing "packages" or packages of major components of housing. Automation in Housing magazine, in its 1973 Factbook, predicts that 70 percent of all housing starts in 1973 will involve the use of at least some major industrialized components (exterior wall units, interior panels, roof trusses, floor systems, utility cores, gable ends, soffit systems, prehung doors, etc.) This level of usage represents an increase from 48 percent in 1969.

Some industry observers believe that the actual level of use of industrialized components in housing is substantially higher. Considering that such factory-made parts as kitchen cabinets and prehung doors are used so commonly, it has been estimated that over 90 percent of all starts include some "manufactured" component. Whatever the precise figure, it is clear that this level of industrialization in housing has been increasing -- most recently in application of the following components:

TRUSSES AND PANELS FOR FLOORS, CEILINGS AND WALLS: These items are used more often than other major industrially produced elements. A recent study by Automation in Housing magazine, conducted in the 10 largest cities in the U.S., showed that over 80 percent of the builders in these markets were using this type of prefabricated item.

MECHANICAL CORES: Mechanical cores are perhaps the most revolutionary innovation in recent years in the home-building industry. These units usually contain an entire kitchen and one or more bathrooms. They come complete with all fixtures, plumbing, installation, and electrical wiring. Although such cores are not really new in that they have been used by one major home manufacturer for the last 10 years, they are starting to gain wider acceptance.

INDIVIDUAL PLUMBING AND ELECTRICAL CORES: In the same family as kitchen/bathroom cores are the individual plumbing cores or "plumbing trees" and electrical cores. These components provide all the plumbing or wiring necessary for

the structure in one package. While accurate figures are not known, the volume of these units is also expected to increase.

Most of the housing starts incorporating manufactured components are still made largely by conventional on-site builders, some of whom have integrated vertically to provide this capability. One of the top ten homebuilders reports that it intends to manufacture components itself for about 40 percent of its units. The number of starts made by conventional on-site builders using manufactured components has, according to Automation in Housing, increased from about 230,000 units in 1969 to almost 500,000 units in 1972.

HOUSING PACKAGES: Although conventional builders are still the primary users of factory-made components, an emerging force in this field is the housing manufacturer who fabricates complete or nearly complete housing "packages," ships them to the site, and assembles the house. The four most prominent kinds of housing "packages" are:

Panelized Housing: A completely prefabricated housing unit that has been "knocked down" and shipped to the site, where it is assembled. These units closely resemble conventionally built homes, but with the advantage of substantial on-site labor and time savings. Moreover, on-site pilferage of lumber and other construction materials is also reduced. The exterior shell of a panelized house can often be assembled on-site and locked up in one day.

Modular Housing: This form of housing production is constructed in three dimensions in a factory and shipped to a site for erection. The three dimensional "building blocks" vary from a block for each room to a complete house as one piece.

Section Housing: A form of modular housing where a complete one story house is fabricated in two sections.

Precut Housing: Another method, which requires comparatively more on-site labor, is the precut package where all individual members are cut to size off-site and assembled on-site.

Despite some well-publicized failures and plant closings, in general, the manufactured housing industry has been increasing its production capacity by 20 to 25 percent a year over the last 10 years. Since 1960, manufactured

housing units shipped increased at an 11 percent compound annual rate -- from 126,800 units to about 440,000 units in 1972. (Chart 16)

In addition to these somewhat "visible" changes in housing production, there are many changes in the manner in which a house is constructed that are totally unnoticeable to anyone not closely associated with homebuilding. Often the changes are small and have little positive or negative impact on the soundness of the structure, but do allow some savings in time and/or money. An example of this type of change is attaching steel beams to wood sills with steel bands instead of using conventional bolts or fasteners. Another new technique is the use of adhesives to attach sheathing to studs to reduce the number of the nailings necessary. However, as indicated earlier, the use of such methods has been limited to an extent by building codes and, in some cases, a lack of awareness of the new techniques.

PRODUCTION AIDS

As the homebuilding industry advances in terms of construction techniques, new aids and tools have been developed to assist the builder. The most significant are those used in actual construction and those devised for increasing the management effectiveness of the homebuilding or manufacturing operation. The most commonly used construction aids that have been developed in the past few years are:

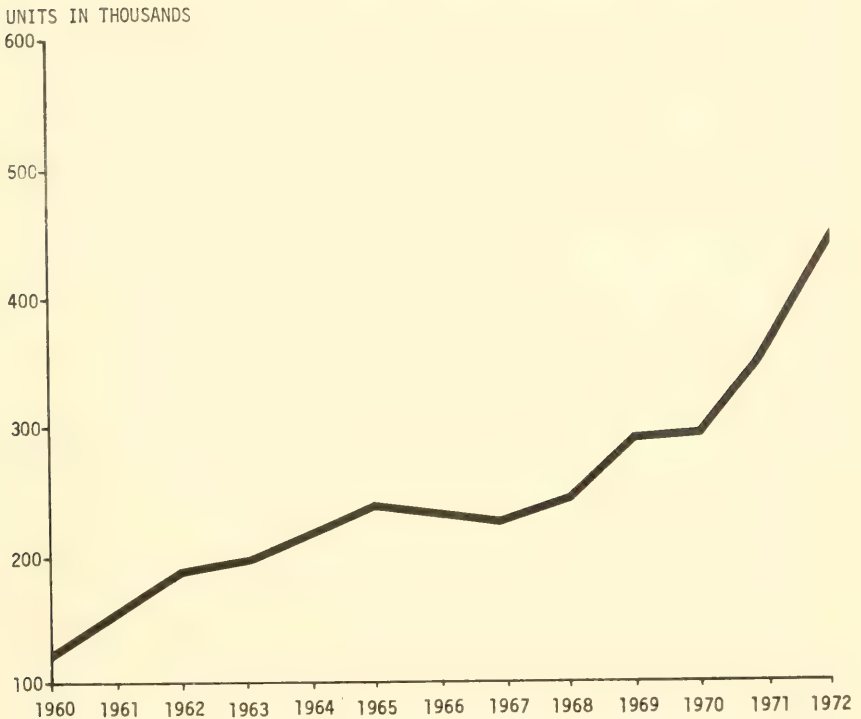
AUTOMATIC GUN-NAILERS: The pneumatic gun-nailer, capable of nailing one nail at a time, has been used for on-site building for quite some time. However, the increase in factory manufacturing of houses and house components has lead to the development of new guns that are capable of multiple, simultaneous nailing.

PANEL CRANES: As a result of the increased use of panels for the floors, walls, and ceilings, cranes attached to the transport truck have become widely available to lift and place these panels in their proper position at the building site.

TRUSS ASSEMBLY FORMS, FRAMING TABLES, SHEATHING MACHINES: As may be self-evident, these items assist in the assembly of major components of the house.

CHART 16

MANUFACTURED HOUSING UNITS SHIPPED



NOTE: COUNTS ONLY COMPLETE HOME PACKAGED AND MODULAR TYPE UNITS THAT CONFORM TO LOCAL BUILDING CODES AND ARE ELIGIBLE FOR LONG TERM FINANCING.

SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN THE HOUSING INDUSTRY," A 1973 STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, USING DATA FROM THE NATIONAL ASSOCIATION OF BUILDING MANUFACTURERS.

ADHESIVES AND ADHESIVE GUNS: Resin epoxies developed in space technology have been increasingly applied to the housing construction industry. A logical corollary of these new adhesives is the adhesive gun, which dispenses ribbons of adhesive from metal containers. One constraint in the application of such adhesives, however, is lack of controlled climatic conditions that are necessary for the adhesive to set correctly.

MANAGEMENT TOOLS

Computers are still rare in homebuilding, but they have been appearing in recent years -- at least with the large home manufacturers. There are, thus far, two primary applications for computers in housing:

ENGINEERING CONSTRUCTION DESIGNS: Some large component manufacturers use computers to identify the kind of lumber, roof pitch, spans, and snowloading capacity required for trusses in various types of houses. The key benefits of such a method are not only savings in time, but a reduction of material wastage through mistakes or miscalculations.

SCHEDULING THE FLOW OF MATERIALS AND PARTS: Another use of the computer is scheduling the cutting of parts and other tasks so that all the components of a particular unit are ready to be shipped out at the same time. As the sophistication of the homebuilding industry grows, the application of computers in production scheduling and purchasing is likely to increase in the larger homebuilding companies.

MATERIALS TECHNOLOGY

The basic materials used for the construction of residential units are wood, concrete, brick, stone, plastic, steel, aluminum, and glass. It is not the basic materials that have changed so much over time as it is their frequency and application in the construction of a house:

WOOD: Although there have been major changes in the application of wood in homebuilding, its frequency of use in its familiar forms is decreasing due to the high cost of lumber. Hardwood floors, for example, are becoming custom options rather than standard features. Doors and window frames are in many cases metal or plastic. Wood as an exterior siding is often used to accent the structure rather than as the basic material, although

wood and wood products have been the major type of exterior wall material for about 30 percent of new one-family homes started each year since 1969.

CONCRETE: Prestressed and precast concrete is being used more extensively for walls, floors and ceilings, in part as a result of increased lumber prices. In some cases, carpeting is being applied directly over the concrete floor slab.

PLASTIC: There has been a significant increase in the use of plastic in all aspects of home construction. One Operation BREAKTHROUGH house, for example, was built with plastic exterior walls. And at least one major builder has indicated that 40 percent of the dwellings that the company will build next year will have fiberglass exteriors. Complete plastic bathroom assemblies have also been developed, and plastic is being used as the basic material for cabinets, insulation, roofing shingles and as "manufactured-marble" vanity tops. Although not extensive at this time, the use of vinyl as an exterior siding is increasing. Perhaps the greatest increase in the use of plastic has been in the use of plastic pipes in plumbing systems.

STEEL: Although traditionally used very extensively in heavy construction, the incidence of steel in residential construction had been fairly limited until recently. However, it is now being used in homes for roof trusses, floor joists, studs, and hollow metal doors -- again in part as a response to high lumber costs.

ALUMINUM: A recent innovation has been the development of the lightweight aluminum frame. One aluminum company predicts that these frames will be used in at least 10 percent of the new houses built by 1980. Aluminum is also being used in doors and, more extensively, as a siding material.

GLASS: Glass is still being employed in the traditional manner in the construction of the home, but there have been some new glasses developed that are being used to provide greater insulation to the home than the traditional flat glass. Both insulating glass and mirror-like reflecting glass are being used to cut down on the heat and air conditioning needed in houses.

OUTLOOK FOR THE FUTURE

As discussed above, technological advances in home-building have been occurring somewhat slowly, and primarily in the direction of providing a fully manufactured

housing "package." The outlook for the future is aided by the general industry consensus that new products, techniques, and materials applications not only produce time and cost savings, but may even be of superior quality and with-in closer tolerances. Moreover, often due to the efforts of architects and the design professions, the typical home-buyer often cannot tell the difference between a "factory-made" house and one that has been built from the foundation up in the traditional manner. Good design can accelerate the use and consumer acceptance of worthy innovations.

Perhaps most important in the future of housing technology is the availability of product testing. Several private concerns, such as the National Association of Home Builders and the American Plywood Association, operate research centers funded for this purpose. Some of the major homebuilders also have their own engineering capability and, in some cases, research divisions. At least one major builder has testing facilities that are not only used for their own products, but for those of other builders as well. But the number of such facilities is still very limited compared to other industries.

An experimental project recently taken on by a major homebuilder in conjunction with at least 10 other corporations is another sign of progress for the industry. As the National Association of Home Builders has been doing over the years, this group of builders constructed and sold a "laboratory" house in Columbia, Maryland, equipping it with a number of new products or innovations that the owners of this house allow to be inspected periodically. Some of the more interesting features are: A prebuilt modular bath/shower component made of seamless fiberglass; solid vinyl siding, "shingle" roofing, which is made of eight foot panels of asbestos that resemble wood shingles; and exterior paneling made of extruded polystyrene board to be used as a substitute for sheathing and insulation.

In sum, the trend has been toward increasing use of technology and other improvements in industrialized techniques in housing production and manufacturing and this trend will undoubtedly continue with rapid advances occurring in the development and use of industrialized parts. How rapidly the industry advances in this direction in the future will depend among other things on the extent to which new modes of construction are properly tested and, equally as important, on the speed at which innovations can be brought into use through approval by governmental authorities.

THE RESPONSIVENESS OF THE INDUSTRY TO CHANGES IN DEMAND

The presence of a large number of small builders who move in and out of the construction industry helps to make the supply of housing very responsive to cyclical changes in demand. The evidence suggests that as demand varies in response to changes in credit conditions, very little change in price is necessary to bring forth changes in production. In fact, there seems to be no significant relationship between the price of housing and the number of units started in the short run.¹⁶

Similarly, the long run supply appears to be very responsive to long run increases in demand. One study suggests that a one percent increase in price in the long run will induce far more than a 10 percent increase in the quantity of housing supplied.¹⁷ However, there is a time lag in the response and only about two-thirds of a long run increase in the desired stock of housing is satisfied within three years.¹⁸

While the supply of housing generally is very responsive to changes in demand, there is some evidence that the subsector of the industry which supplies rental housing responds relatively less to changes in demand. Here, a long run one percent change in rents seems to induce somewhat less than a one percent change in supply.¹⁹ It is difficult to explain this result in light of the evidence on the responsiveness of the housing supply in general. Perhaps, the results are related to the fact that the small builder, who moves easily in and out of the industry, typically

¹⁶William W. Alberts, "Business Cycles, Residential Construction Cycles, and the Mortgage Market," Journal of Political Economy, Vol. LXX, No. 3, June 1962.

¹⁷Richard F. Muth, "The Demand for Non-farm Housing," published in Harvey S. Perloff and Lowdon Wingo, Jr. Issues in Urban Economics, Baltimore: Johns Hopkins University Press, 1968, pp. 286-291.

¹⁸Richard F. Muth, "The Demand for Non-farm Housing," published in Arnold C. Harburger, editor, The Demand for Durable Goods, Chicago: University of Chicago Press, 1958.

¹⁹Frank de Leeuw and Nkanta F. Ekanem, "The Supply of Rental Housing," American Economic Review, Vol. LXI, No. 5, December 1971.

concentrates his efforts on the single-family home constructed for potential owners. On the other hand, it must be noted that our statistical techniques are still very primitive and definitive conclusions are not yet possible. Future research may reveal less of a difference between the relative responsiveness of the rental and homeowner markets.

CHAPTER 8

THE COST OF HOUSING

The surge in the rate of household formation in recent years has been one of the most important factors in the large increase in the demand for housing, which, in turn, has resulted in record levels of housing production. The increase in production required larger quantities of productive resources for residential construction, and some increase in the relative price of housing was necessary to attract these resources.

This Chapter analyzes the recent relative price increase and places it in historical perspective. While the analysis is complex, the conclusions are straightforward. It is shown that over the last two decades, most measures of income have far outrun housing costs even though the gap has narrowed somewhat during the last 5 years. In this period the percentage increase in homeownership costs has roughly matched the increase in income. On the other hand, rental costs have continued to increase much less rapidly than income.

Despite the relatively rapid rise in homeownership costs, Americans have continued to purchase approximately the same quality of housing as they did before relative housing costs accelerated rapidly. While this has required greater housing expenditures, the fact that money income has risen faster than other prices has meant that households could increase housing expenditures enough to maintain housing quality while continuing to buy more of non-housing goods and services as well.

THE RISING PRICE OF HOUSING

DEFINING HOUSING PRICE

Before analyzing changes in the costs of housing, it is necessary to explain in precise terms what is meant by "housing," "housing services," and "housing costs."

The nature of housing changes through time, and the typical house of 1973 is quite different from the house of 1900. Size, number of rooms, number of bathrooms, the presence or absence of central air conditioning, and other amenities -- all can vary through time and affect the price

of housing. When the average price of a house sold goes up, therefore, it is difficult to determine whether the increase represents a true inflation in housing costs or whether the price increase indicates that the consumer is getting a larger and higher quality home for his money.

Moreover, buying houses is only a small part of the effort involved in providing housing for American households. First, 37.1 percent of all households were renters in 1970. Second, the home purchase or construction is only the first step in providing housing. The house has to be maintained and operated by someone and this involves purchasing a whole array of complementary services such as utilities, repairs and maintenance, insurance, and those public services which are "purchased" through real estate taxes. Renters also purchase these services, paying for them as part of their rent.

To a person about to buy a house, of course, the price of the house itself and the credit conditions which determine the downpayment and the interest rate are of prime importance. This, however, is of concern to the small fraction of homeowners buying homes each year, less than 9 percent in 1970, for example. The vast majority of American households are not house buyers in any one year and, for them, it is the cost of renting or living in their own house which is of prime importance.

Various Government agencies compute indexes of the price of buying or renting living space and the prices of all of the complementary services purchased by the "typical" household. The agencies make an effort to compare the price of identical houses and bundles of auxiliary services at different points of time, but housing is such a complex good that this is not always possible. For this reason, the indexes of price are often far from perfect. Subsequent sections of this Chapter will describe the most important weaknesses in the data and, wherever possible, the impact of the resulting statistical inaccuracies will be assessed. In addition, wherever possible, a number of different indexes are used in order to provide substantiation of major trends.

HOUSING COST AND INCOME

As noted in the introduction, relatively rapid increases in housing costs are a recent phenomenon. Housing costs have gone up a great deal over the last 20 years, but so have the prices of most other goods and services, and so has the income of the typical household. Table 1 compares changes in

TABLE 1

CHANGES IN INCOME AND HOUSING COSTS 1953-1972

MEASURE OF INCOME OR COST	PERCENTAGE INCREASE OVER THE PERIOD		
	1953-1972	1963-1972	1967-1972
PER CAPITA DISPOSABLE INCOME	141%	78%	39%
HOURLY EARNINGS IN MANUFACTURING	119	55	35
CONSUMER PRICE INDEX (CPI)	56	37	25
HOUSING COMPONENT OF CPI *	60	39	29
SHELTER COMPONENT OF CPI	76	48	34
RENT COMPONENT OF CPI	48	25	19
COST OF HOMEOWNERSHIP COMPONENT OF CPI	87	57	40

* RENT AND HOMEOWNERSHIP, TOGETHER WITH A MINOR HOTEL-MOTEL EXPENDITURE COMPONENT, COMPRISE THE SHELTER COMPONENT OF THE CPI. THE SHELTER COMPONENT, IN TURN, IS ONE OF THE COMPONENTS MAKING UP THE HOUSING COMPONENT; THE OTHERS ARE FUEL AND UTILITIES, AND HOUSEHOLD FURNISHINGS AND OPERATIONS.

SOURCE: DEPARTMENT OF COMMERCE, BUSINESS CONDITIONS DIGEST, SEPTEMBER, 1972 AND JULY, 1973; DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, EMPLOYMENT AND EARNINGS, JULY, 1972, TABLE C-1; HANDBOOK OF LABOR STATISTICS, 1972, TABLE 127; MONTHLY LABOR REVIEW, MAY, 1973, TABLE 25.

two basic measures of income to changes in the overall Consumer Price Index, and to changes in the housing price measures which are part of that index.

The two income measures are per capita disposable income (income after taxes) and hourly earnings in manufacturing. Disposable income is the better single measure of purchasing power, but the hourly earnings figure is also of interest because part, though by no means all, of the overall increase in income is due to the growth in the number of families with two working members.

The Consumer Price Index, compiled by the Bureau of Labor Statistics, is the most commonly used measure of changes in the cost of living. Since 1953, it has included a "Housing" price index as one major component. The housing price index is a weighted average of the cost of renting and of owning a house, including maintenance and repair expenditures, property taxes and insurance, as well as the purchase price or rent for the housing unit itself; the index also contains the cost of buying fuels, utilities, and home furnishings. The housing component of the Consumer Price Index is thus the broadest available measure of the cost of occupying housing. Over the 20 years that it has been compiled it has increased much less rapidly than either measure of income discussed above. Hourly earnings increased twice as fast as housing costs, and per capita income increased more rapidly still.

The change in the housing cost index is actually the result of price changes occurring among a variety of housing services. This raises the possibility that the changes shown in the housing index could be masking significant increases in some of its components, which are being offset by less than average increases in other components. On closer inspection, there is evidence that this is indeed the case, and that the behavior of the housing price index does not tell the complete story.

To begin with, the housing index includes home furnishings, and also fuels and utilities. Both have risen relatively little over the past 20 years; furnishings went up 33 percent, and fuels and utilities 45 percent. When they are omitted, it appears that the price of housing itself (defined as "Shelter" in the Consumer Price Index) has risen more sharply -- by 76 percent in the last two decades. This is still much less than the increase in either measure of income, however.

Shelter consists of both rental and homeowner housing cost components. When these are examined separately, the prices of housing services purchased by renters and homeowners appear to have changed in very different ways. Whereas the cost of renting has risen by only 48 percent over the past 20 years, the cost of homeownership went up by 87 percent. Again, both have risen much less than either measure of income, but the cost of homeownership has risen much faster than other components of the housing cost index.

When shorter, more recent periods are investigated, the picture changes somewhat. For the 1963-1972 decade, per capita disposable income continued to rise more rapidly than all measures of housing cost, but homeownership costs and hourly earnings in manufacturing rose at about the same rate. The situation has changed still more noticeably in the 5 year period from 1967 to 1972. Per capita income rose by 39 percent, and hourly earnings in manufacturing by 35 percent, while the cost of owning a home rose by 40 percent. The main reason for the change in this most recent period is a marked increase in costs; income has been rising nearly as rapidly in the last 5 years as in the longer periods. Nonetheless, when renters as well as homeowners are considered, costs rose by only 34 percent, which was slightly less than the increase in either measure of income. This occurred because the rent index increased by only 19 percent. Put another way, the average wage earner was able to live in the same or better house in 1972 than he did in 1967, without having to increase the portion of his total budget spent for housing.

CHANGES IN THE RELATIVE PRICE OF HOUSING

Since all measures of housing cost (as well as the overall Consumer Price Index) have increased much less rapidly than income, it is not surprising that the last two decades have seen the dramatic improvement in housing conditions described in Chapter 6. However, Table 1 also shows that the price of housing has increased more rapidly than the overall Consumer Price Index, so that the price of housing relative to prices of all the other goods and services typically bought by consumers, has increased. This section evaluates the importance of the increase in the relative price of housing and its components.

Table 2 shows the year-to-year changes in the Consumer Price Index and the major categories of the housing index. Between 1953 and 1972, the housing index increased by 60 percent, or at a compound annual rate of about 2.4 percent. The average price of all consumer goods, however, increased

TABLE 2

THE PRICE OF HOUSING, 1953-1972

(COMPONENTS OF THE CONSUMER PRICE INDEX)

YEAR	ALL GOODS (CPI)	HOUSING		SHELTER		RENTAL		HOMEOWNER	
		ABS.	REL.	ABS.	REL.	ABS.	REL.	ABS.	REL.
1953	80.1	80.8	1.01	76.5	.96	80.3	1.00	75.0	.94
1954	80.5	81.7	1.01	78.2	.97	83.2	1.03	76.3	.95
1955	80.2	82.3	1.03	79.1	.97	84.3	1.05	77.0	.96
1956	81.4	83.6	1.03	80.4	.97	85.9	1.06	78.3	.96
1957	84.3	86.2	1.02	83.4	.97	87.5	1.04	81.7	.97
1958	86.6	87.7	1.01	85.1	.98	89.1	1.03	83.5	.96
1959	87.3	88.6	1.01	85.0	.99	90.4	1.04	84.4	.97
1960	88.7	90.2	1.02	87.8	.99	91.7	1.03	86.3	.97
1961	89.6	90.9	1.01	88.5	.99	92.9	1.04	86.9	.97
1962	90.6	91.7	1.01	89.6	.99	94.0	1.04	87.9	.97
1963	91.7	92.7	1.01	90.7	.99	95.0	1.04	89.0	.97
1964	92.9	93.8	1.01	92.2	.99	95.9	1.03	90.8	.98
1965	94.5	94.9	1.00	93.8	.99	96.9	1.03	92.7	.98
1966	97.2	97.2	1.00	96.8	.99	98.2	1.01	96.3	.99
1967	100.0	100.0	1.00	100.0	1.00	100.0	1.00	100.0	1.00
1968	104.2	104.2	1.00	104.8	1.01	102.4	.98	105.7	1.01
1969	109.8	110.8	1.01	113.3	1.03	105.7	.96	116.0	1.06
1970	116.3	118.9	1.02	123.6	1.06	110.1	.95	128.5	1.10
1971	121.3	124.3	1.02	128.8	1.06	115.2	.95	133.7	1.10
1972	125.3	129.2	1.03	134.5	1.07	119.2	.95	140.1	1.12

CHANGE IN PRICE

RELATIVE TO CPI, 1953-1972 +2.0% +11.5% -5.0% +19.1%

ABS. = ABSOLUTE VALUE OF COMPONENT OF THE CONSUMER PRICE INDEX.

REL. = COMPONENT DIVIDED BY CONSUMER PRICE INDEX.

SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, HANDBOOK OF LABOR STATISTICS, 1971, TABLE 127; MONTHLY LABOR REVIEW, MAY 1972, TABLES 24 AND 25, FEBRUARY 1973, TABLES 24 AND 25.

nearly as much, 56 percent, over the same period. The price of housing, then, relative to the price of all goods, has risen by only 2 percent ($1.60 \div 1.56 = 1.02$) in 20 years -- one-tenth of 1 percent per year.¹

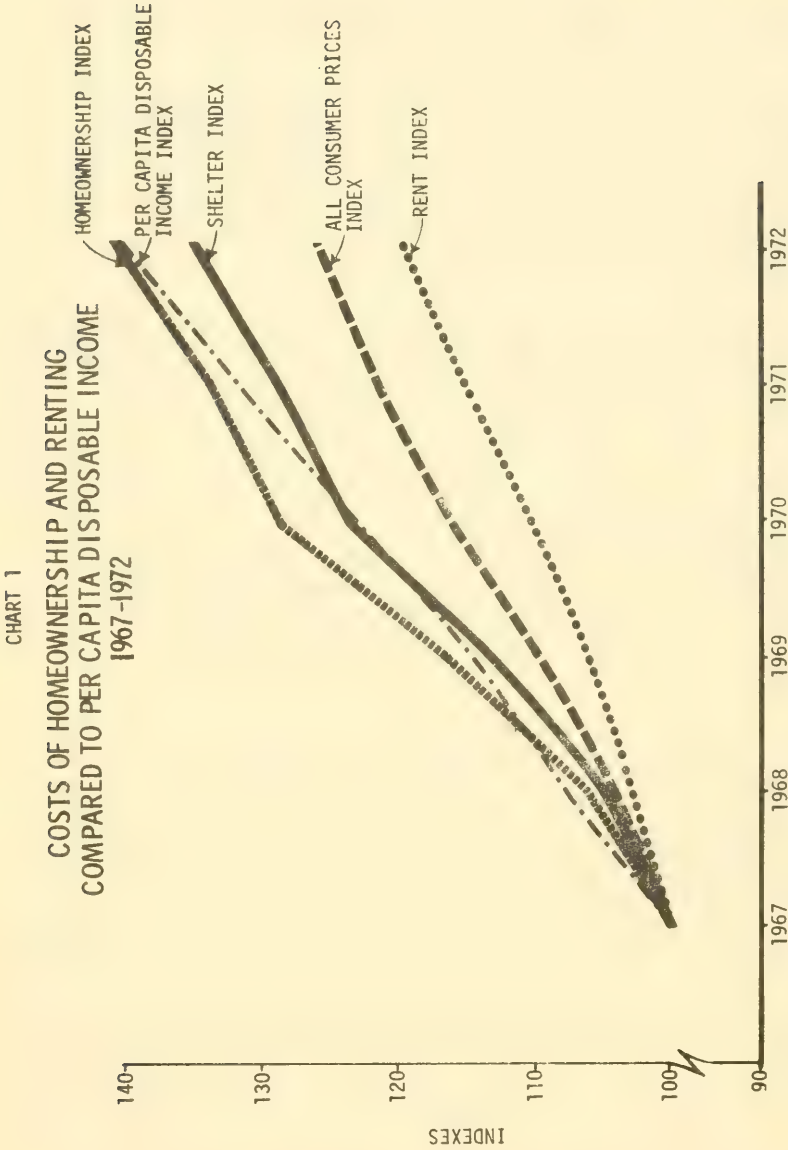
The components of the housing index show somewhat greater changes. The shelter component, for example, rose by 11.5 percent in 20 years relative to the Consumer Price Index. Most striking, however, is the behavior of the rent and homeownership indexes. The cost of renting declined relative to the cost of all goods -- by 5 percent in 20 years. The relative cost of homeownership, on the other hand, rose by 19.1 percent in the same period.

Although the cost of homeownership increased relatively throughout the period, the increase has accelerated recently; over two-thirds of the increase has occurred since 1967. Thus, whether considered relative to income or to the cost of all goods, the cost of homeownership has been rising sharply in recent years. (See Chart 1.)

However, per capita disposable income still increased considerably more rapidly than the overall Consumer Price Index over the 1967-1972 period (39 percent vs. 25 percent). Consequently, if it wished, the typical home-owning household could maintain its standard of housing consumption in the face of rapidly rising housing prices without having to sacrifice its consumption of other things. Renters will be in a still better position because rents increased only half as fast as income.

What scant data are available for the first half of 1973 suggest that the situation actually has improved since 1972, in that the relative price of housing has declined. Between June 1972 and June 1973, for example, the cost of homeownership increased by 3.9 percent, while the overall Consumer Price Index grew at 5.9 percent. The rate of growth of per capita disposable income for the same period was 10.0 percent -- much greater than for either the Consumer Price Index or its homeownership component. Data for the last half of 1973, however, may reveal some acceleration in the

¹This relatively slight shift is typical of the major components of the Consumer Price Index; the relative price of clothing, for example, decreased by 8.0 percent in the same period.



SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, BUSINESS CONDITIONS DIGEST, SEPTEMBER 1972 AND AUGUST 1973; DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, MONTHLY LABOR REVIEW, MAY 1973, TABLE 25.

rate of increase of homeownership costs because of the very rapid increase in interest rates experienced during the summer.

COMPONENTS OF HOMEOWNERSHIP COSTS

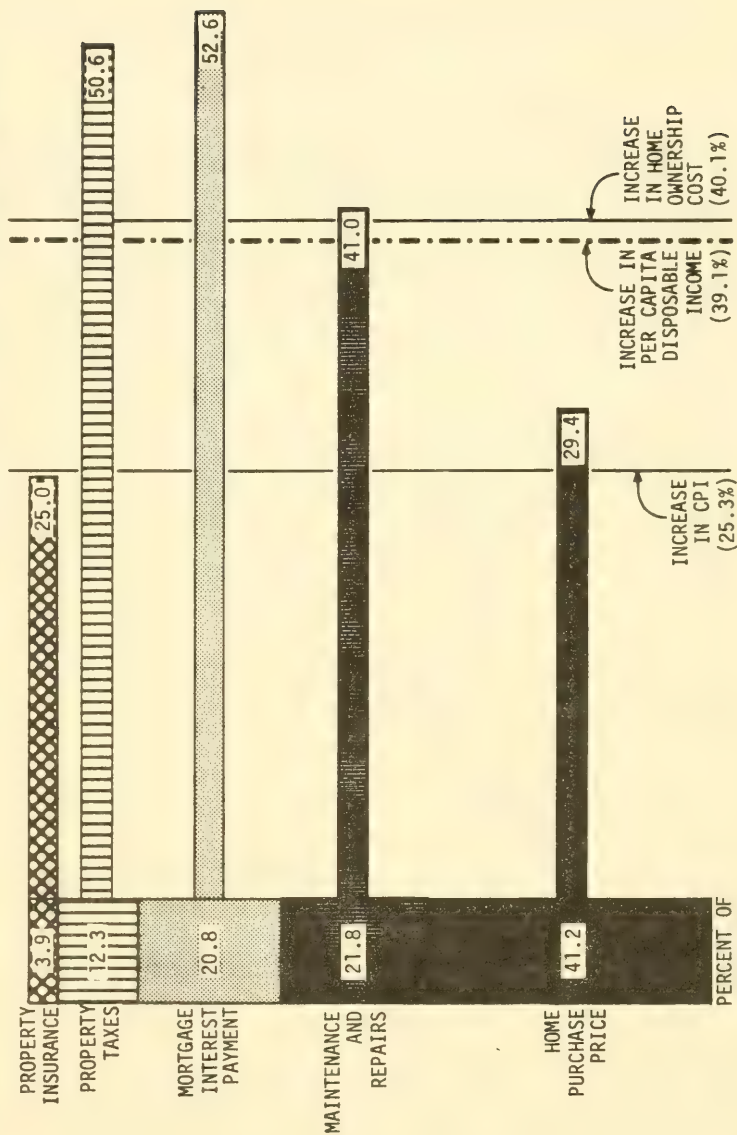
Because the most rapid rise in housing costs has occurred over the period 1967-1972, the analysis of the components of the cost increase will be focused on this period. Only the components of homeownership costs are studied, because data are not available to apply a comparable analysis to the rental index. Moreover, it is the homeownership index which has risen most rapidly. However, because of the significantly lower rental cost increases, care must be taken to avoid assuming that homeownership cost trends necessarily reflect overall trends.

Chart 2 breaks down the homeownership index into its components and shows the weight of each in the overall index. Mortgage interest payments and property taxes have risen most rapidly, and have increased faster than per capita disposable income; maintenance and repair expenses have risen just about as fast as income; while home purchase price has risen more slowly than income, and only slightly more rapidly than the overall Consumer Price Index. However, home purchase price has a heavy weight in the computation of the index and, as a result, it has been the most important factor increasing the cost of homeownership. Each component's weighted contribution to the overall homeownership cost increase of 40.1 percent over the 5 year period is provided in Table 3.²

²The home purchase price and mortgage interest payment components of the Consumer Price Index are not publicly available and, therefore, could not be published in this Chapter. The figures used in the Chapter are derived from the published "expenditure weights" for home purchase and mortgage interest payment; changes in these weights can be used to determine close approximations to the changes in the unpublished index numbers. The "expenditure weights," however, refer only to the month of December in each year; other series used are annual averages. Thus, the home purchase and mortgage interest payment data are not precisely comparable to the other data; calculations using all of the series include slight rounding errors and other minor discrepancies as a result. The source for the "expenditure weights" is Relative Importance of Components in the Consumer Price Index, published annually by the Bureau of Labor Statistics, Department of Labor.

CHART 2

PERCENT INCREASE IN HOMEOWNERSHIP COSTS AND PER CAPITA INCOME, 1967-1972



SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, RELATIVE IMPORTANCE OF COMPONENTS IN THE CONSUMER PRICE INDEX; HANDBOOK OF LABOR STATISTICS, 1972; MONTHLY LABOR REVIEW, FEBRUARY 1973, TABLE 25.

COMPONENTS OF CHANGE IN HOMEOWNERSHIP COST INDEX, 1967 - 1972

COMPONENT	WEIGHTED ABSOLUTE CONTRIBUTION	PERCENTAGE CONTRIBUTION
HOME PURCHASE PRICE	12.4	30.9%
MORTGAGE INTEREST PAYMENTS	11.2	27.9
MAINTENANCE AND REPAIRS	9.2	22.9
PROPERTY TAXES	6.3	15.7
PROPERTY INSURANCE	1.0	2.5
TOTAL	40.1	100.0%

NOTE: DETAIL MAY NOT ADD TO TOTALS BECAUSE OF ROUNDING.

SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, RELATIVE IMPORTANCE OF COMPONENTS IN THE CONSUMER PRICE INDEX; HANDBOOK OF LABOR STATISTICS, 1972; MONTHLY LABOR REVIEW, FEBRUARY 1973, TABLE 25.

While the increase in home purchase price has contributed most to the increase in the overall cost of homeownership, the more rapid relative increases in mortgage interest payments, maintenance costs, and property taxes have caused their relative importance in the homeownership price index to rise while the relative weight of the home purchase price has been falling.

Before discussing in detail the changes in the components of the cost of homeownership, two general points deserve attention. First, the importance of mortgage interest payments and property taxes is overstated in the Consumer Price Index, for many homeowners. Both interest and taxes are deductible from Federal income tax liability, for those homeowners who itemize deductions. Other costs of homeownership are not deductible. Thus, in terms of out-of-pocket costs, net of taxes, mortgage interest and property taxes will have less weight for the typical homeowner than they do in the Consumer Price Index. The value of the deduction depends on the income of the homeowner; the higher his tax bracket, the smaller the share of his interest and property tax payments he actually pays. In particular, over time, the value of the tax deduction increases as the individual homeowner's income increases and he moves into a higher marginal tax bracket. Thus, for any homeowner whose income has increased since 1967, and who itemizes deductions, a 10 percent increase in property taxes is in reality less of an increase in his cost of homeownership than is a 10 percent increase in, say, maintenance and repair expenditure.³ Put another way, the Consumer Price Index components measure the cost increases incurred by those homeowners whose incomes have not increased since 1967, or who do not itemize deductions.

By contrast, the changes in the rent index do measure cost increases experienced by typical renters. Renters are not able to deduct from their taxable income the portions of their rents which go to pay the property taxes and mortgage interest payments of their landlords. Part of the difference in the movements of rent and homeownership indexes may be due to this difference in the tax impact of cost increases, to the extent that landlords are forced by competition to keep rent increases in line with their cost increases after tax advantages have been taken into account.

³A more detailed discussion of the deductibility of mortgage interest and property taxes is contained in Chapter 2.

The second qualification refers to the home purchase price and mortgage interest payment series. These series reflect changes in the initial cost of acquiring a house rather than in the on-going costs of operating and maintaining it. For most households, the purchase of a house is a relatively infrequent occurrence. The fact that prices of houses, and mortgage interest rates, have risen since 1967 does not affect the out-of-pocket housing costs of those families who bought and financed houses prior to 1967. In other words, the Consumer Price Index cost of homeownership index thus tends to overstate their current housing costs.

There are relatively few households actually affected directly by changes in home prices and mortgage interest rates. For example, 64 percent of all households owning their own home in 1970 had occupied those same homes for at least 5 years.

Moreover, rising home prices have little impact on homeowners who seek to sell one house and buy another; in general, the prices of both houses will rise together, so that the homeowner is "leveraged," benefitting from the 30 percent rise in the price of the home he now owns, and paying 30 percent more for the house he buys than he would have had to pay in 1967. The change in the home purchase component of the Consumer Price Index is not applicable to these homeowners; the cost increase applies only for the household which is buying a house for the first time, such as a renter or a newly formed household.⁴

The change in mortgage interest rates, however, does represent a cost to all home buyers, including those who previously owned their own home. The interest rates at which these households financed mortgages on their present houses typically are much lower than those reflected in the current homeownership index. Thus, a rise in home prices does not affect all home buyers, but a rise in mortgage interest rates does.

⁴A family seeking to move to a better house will, of course, have to pay more for it, but this does not affect the argument if both houses increase in value at the same rate; the family's original house would represent the same fraction of the value of the new house in both 1967 and 1972. For families whose homes have experienced changes in value that are significantly different from the average, the impact may be substantially different when they move.

It can also be argued that maintenance and repair expenses are infrequent items for households, although perhaps more common than home purchase or financing. This is probably true of the major repairs, but all homeowners are likely to have some, minor, maintenance expenses in any one year.

To summarize, the cost of homeownership index is comprised of two costs which all owners must pay each year, property taxes and insurance; one which they probably face each year, maintenance and repairs; one which they face only when buying a house, mortgage interest payments; and one which they face only when buying a house for the first time, the home purchase price. The overall increase in the cost of homeownership thus does not apply to all, or even most, homeowners; however, two of the three rapidly rising components, property taxes and maintenance expenses, probably do affect all homeowners.

HOME PURCHASE PRICE: Although other components are increasing much more rapidly, home purchase price remains the largest single component of overall homeownership costs and, therefore, it merits special attention. Table 4 isolates some of the elements comprising new home purchase price; these, in turn, affect the price of an existing home.

Land Cost: The most striking element in higher home purchase prices is the increase in the cost of land. The relative cost per square foot of new housing sites has risen by 58 percent since 1967. Not surprisingly, therefore, land now accounts for a larger fraction of the total value of new houses than at any time since World War II. The fraction undoubtedly would have been still larger had it not been for a sharp decline in lot size of some 12 percent since 1967.

New housing sites tend to be located in outlying areas, away from the existing housing concentrations in central cities and nearby suburbs. Many factors account for the increasing demand for new housing in general and for suburban housing in particular -- all of which contribute to the substantially increased cost of acquiring new housing sites. It has been persuasively argued, for example, that the relatively large increase in the demand for housing is partially the result of the children of the post-World War II "baby boom" reaching homeownership age and to changing life styles. Two factors commonly supposed to have greatly

TABLE 4

RELATIVE PRICES OF HOUSING CAPITAL INPUTS, 1963-1972

YEAR	SITE VALUE ⁽¹⁾	LABOR COSTS ⁽²⁾	CONSTRUCTION ⁽³⁾ MATERIAL COSTS
1963	NA	.90	.95
1964	NA	.92	1.01
1965	1.00	.94	1.01
1966	.97	.97	1.02
1967	1.00	1.00	1.00
1968	1.06	1.02	1.01
1969	1.08	1.07	1.02
1970	1.29	1.09	.97
1971	1.41	1.13	.99
1972	1.58	1.15	1.01

NA = NOT AVAILABLE

(1) SOURCE: MEDIAN PRICE OF SITE PER SQUARE FOOT OF NEW FHA HOMES, FROM TABLE 197, OF 1971 HUD STATISTICAL YEARBOOK, AND FHA TRENDS, 3RD QUARTER 1972, AND MADE RELATIVE TO THE CPI.

(2) SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, EMPLOYMENT AND EARNINGS, JULY 1973. THE AVERAGE WEEKLY EARNINGS OF CONSTRUCTION WORKERS FROM TABLE C-1 MADE RELATIVE TO CPI.

(3) SOURCE: DEPARTMENT OF COMMERCE, CONSTRUCTION REVIEW, MAY 1973 AND JUNE 1967, TABLE E-2. THE INDEX OF ALL CONSTRUCTION MATERIALS WAS MADE RELATIVE TO THE CPI.

enhanced the appeal of suburban living are improved transportation systems (particularly, the growing network of highways and expressways) and a gradual drift of employment and other community infrastructure towards the suburbs -- both of which tend to reduce the commuting time and costs for many suburban residents.

It is difficult to predict how long such large increases in the cost of land used for new housing will continue, particularly since the trend could be slowed or reversed by changes in any number of factors, such as a reduction in the rate of new household formation. It is unlikely, however, that the trend toward higher prices for residential land in general will be reversed because land tends to become available very slowly for housing uses in response to expanding metropolitan areas. Moreover, "no growth" policies and other environmental controls will probably further limit the amount of land available for new construction in the future.

Construction Cost: Housing construction costs, the other basic determinant of a home's purchase price, also have risen more rapidly than has the general price level, although much less sharply than has the cost of land. Table 4 shows that the wages of construction labor have increased by 15 percent since 1967, relative to the Consumer Price Index.⁵ To some extent this cost increase has been offset by productivity increases.

In contrast to rapidly rising land prices, which seems to be a rather recent phenomenon, rising construction costs seem part of a long-run trend stretching back

⁵These labor costs are based on the average weekly earnings of contract construction workers, both union and non-union, and reflect premium pay for overtime and late shift work as well as basic pay. Because average hourly earnings also reflect such premium pay, their use would not alter the results reported here.

It should also be noted that contract construction workers include workers besides those in residential construction. However, when average weekly earnings of construction workers engaged in building construction are used, the results are not significantly different. These data probably also overstate the amount of union labor employed in residential construction; however, since many residential construction workers are not covered by contract construction data.

to World War II. If, as has been suggested, the rapid rise in the cost of new home sites is largely attributable to a sudden spurt in housing demand, why have construction costs risen less dramatically? The most obvious explanation is that labor and construction materials are mobile resources while land is not; consequently, they are more readily diverted away from other uses in response to an increased demand for housing.

While construction materials costs have gone up relatively little on the whole, a few specific materials have undergone large price increases. Lumber prices, for example, have increased by 59 percent since 1967 (27 percent relative to the Consumer Price Index); plywood and millwork prices have also increased more rapidly than has the Consumer Price Index. The average prices of nearly all other building materials, however, have increased very little, so that the overall increase in construction materials costs is less than the Consumer Price Index increase.

The discussion of construction costs, thus far, has focused on changes in prices of the principal resources that go into housing, namely, materials and labor. Clearly, however, it is the change in the cost of the finished structure, and not the change in the cost of ingredients, that matters to the buyer.

As already noted, between 1967 and 1972 the Consumer Price Index home purchase component rose 29.4 percent or 3.3 percent relative to the total Consumer Price Index. Comparable increases are recorded by an index of housing construction costs computed by the Bureau of Economic Analysis, formerly the Office of Business Economics of the Department of Commerce, which shows a 4 percent relative increase, and one by the Bureau of the Census showing a 4.5 percent relative increase. These relatively modest increases in home purchase price and construction costs suggest that none of these indexes may adequately reflect all the relevant costs involved in producing a house, especially with relative costs of land and construction labor increasing by 58 and 15 percent, respectively. There are, in fact, a number of possible explanations.

First, the relatively slow growth in the cost of materials has compensated somewhat for the increased price of labor.

Second, just as home builders can alter the mix of materials to economize on more expensive inputs, they also have considerable opportunity to adjust the construction process in response to increased labor costs. For example, prefabricated components increasingly have been substituted for on-site production activity. This has permitted labor productivity gains to be realized, especially through the greater use of those mass production techniques which are more readily implemented in a manufacturing plant than at the building site. In the absence of a suitable measure of overall construction labor productivity, therefore, any assessment of the true labor construction costs at this point would be highly conjectural. Instead, it can be said with confidence only that the labor cost measures used in this section are biased upward. By abstracting from productivity changes, they tend to overstate the importance of labor cost increases in the overall cost increase for housing.⁶

Third, none of the indexes handles land properly. Neither the Consumer Price Index nor the Census home purchase index keeps the size of lot constant and, consequently, as lot sizes are decreased in response to increased land prices, the total land cost component of the "standard house" rises much more slowly than does the price of land per square foot. The Bureau of Economic Analysis index does not include land at all.

⁶ The widely-known Boeckh Index of residential construction costs, including both labor and material costs, has increased by 16 percent more than has the Consumer Price Index since 1967. This index may tend to overstate the true increase, however, since only union wages are used in determining labor costs, and a large fraction of home construction is produced by non-union workers. (U.S. Department of Labor, Bureau of Labor Statistics Report 417, Selected Earnings and Demographic Characteristics of Union Members, 1970 found that median annual earnings of construction union members -- male, full time -- exceeded earnings of non-union members by almost \$4,000.) The Boeckh Index also differs from the other indexes because of differences in the statistical procedures used to calculate them. In particular, the Boeckh Index does not adjust for productivity increases or for substitution of one material for another.

In other words, all of the indexes understate the true rise in the cost of an identical house on an identically sized lot.⁷

On the other hand, specific measures of land costs tend to exaggerate the rate at which the cost of housing sites is rising. The particular measure used here -- median-price per square foot of new home sites insured under FHA Section 203 -- contains two biases, both of which overstate the increase in land costs in the Consumer Price Index home purchase price component. For one thing, some two-thirds of all new, single-family homes are not FHA-insured so that their costs may be poorly represented by the index based on FHA data, especially because for homes insured under Section 203 the average ratio of land cost to sales price per unit is higher than it is for homes financed differently. In 1971, for example, Section 203 homes had an average site-to-value ratio of 21.2 percent as compared with an average ratio of 18.3 percent for all homes. Consequently, increased land costs are likely to have been less important to the typical home purchaser than the Consumer Price Index home purchase series indicates. A considerable portion of higher land costs also stems from increased fees and charges for various amenities available at the housing site. However, it is difficult to distinguish between those increases which represent payments for real quality improvements and those manifesting pure price increases. For example, a site for a new house may command an increased price because a new street or sewer line is constructed adjacent to it or the higher price may be due, say, to a moratorium on sewer hookups which effectively limits the supply of building sites and thereby intensifies inflationary pressures. In the former case, the increase in price is due to an improvement of the site; in the latter, there is a pure price increase.⁸

MORTGAGE INTEREST PAYMENT: The increase in the mortgage interest payment component is the second most important factor in explaining the 40.1 percent increase in homeowner-

⁷All of this is not to say that these are not valid, useful indexes. The point is that they are not entirely appropriate to the specific requirements of this study. The three indexes are further described in Appendix A.

⁸A more complete analysis of the land price data is provided in Appendix D.

ship costs occurring between 1967 and 1972. As shown in Chart 2, mortgage interest payments in 1967 were only about half as large as the costs subsumed under "home purchase price;" however, during the following 5 year period, the mortgage interest payment component increased at a much faster rate (52.6 percent vs. 29.4 percent). As a result, between 1967 and 1972, increased mortgage interest payments contributed nearly as much to the increase of homeownership costs as did the increased home purchase price, i.e., 27.9 vs. 30.9 percent.

It is extremely important to note that the increased mortgage interest payments reflect both an increased mortgage interest rate and an increased principal against which the interest rate is assessed. With an unchanged loan-to-value ratio,⁹ over half of the increased mortgage interest payments occurring during the 1967-1972 period is due to the increased home purchase price.

An index of mortgage interest rates, published by the Bureau of Labor Statistics, has risen by 17.5 percent in the past 5 years. (The mortgage interest payment component of the homeownership cost index is approximately the product of the home purchase price series and the mortgage interest rate series; for 1972, the mortgage interest payment component was 1.526 which is approximately 1.294 times 1.175, the values of the home purchase price and the mortgage interest rate series, respectively.)¹⁰ Allowing for the influence of increased home purchase prices and proportionately larger mortgages, increased mortgage interest rates account for about one-eighth of the 1967-1972 increase in overall homeownership costs, i.e., homeownership costs would have risen by 35.2 percent rather than 40.1 percent were it not for higher interest rates.

Looking to the future, the mortgage interest rate index is expected to exceed 130 by the end of 1973. This alone will push up the overall homeownership cost index by about 3.2 percent. An example of how this rate increase can be further leveraged by an increase in the principal is pro-

⁹ A constant loan-to-value ratio is maintained in the mortgage interest payment index by adjusting, monthly, the base period amount of the loan by the Consumer Price Index change in home purchase price.

¹⁰ The approximation occurs because of the nature of the calculating procedure used to derive the mortgage interest payment component.

vided by arbitrarily assuming that the home purchase price index rises at the same rate in 1973 as it did in 1972. The increased mortgage principal will magnify the impact of increased interest rates, causing total homeownership cost to increase by some 4.5 percent in 1973.

While measuring a general rise in mortgage interest rates, the cost index masks some very important fluctuations in the interest component of housing costs which occurred during the 5 year span. Interest rates rose significantly from 1967 to 1970 and then fell abruptly until the beginning of 1972. (See Table 5.) A sharp increase has been experienced since the spring of 1973, and this will add significantly to the cost of homeownership. However, interest rates enter the Consumer Price Index with a time lag and their impact on the Consumer Price Index do not appear immediately.

MAINTENANCE AND REPAIR COSTS: The third most important factor contributing to the homeownership price increase in the period 1967-1972 has been the cost of maintenance and repairs, which rose 40.7 percent or 12.0 percent relative to the total Consumer Price Index. When these costs are broken down, it appears that the cost increase is due mostly to increased labor costs. Maintenance services such as "repainting living and dining rooms" rose by 48 percent from 1967 to 1972 -- 18 percent relative to the Consumer Price Index. By contrast, maintenance commodities, such as paint, rose by only 24 percent -- declining by 1 percent relative to the Consumer Price Index. This is very similar to the pattern for overall construction costs, in which labor rose rapidly and materials were stable.

PROPERTY TAXES: While property taxes rose even faster than maintenance and repair costs, they have a lower weight in the Consumer Price Index and, on balance, contributed less to the overall price increase. Moreover, only part of the tax increase represents a true price increase. Some part of the rise in taxes has been used to finance an increase in the supply of local public services -- more schools, police protection, etc. To the extent that more services have been provided, the index overstates the relative increase in housing costs (Chart 3).

It is possible that property taxes will increase much less in the near future than they have in the recent past. Part of the recent tax rate increases is due to the need to provide education for the children of the postwar "baby boom" as they grew up; these children have now finished school, and the need for increased educational expenses has

TABLE 5

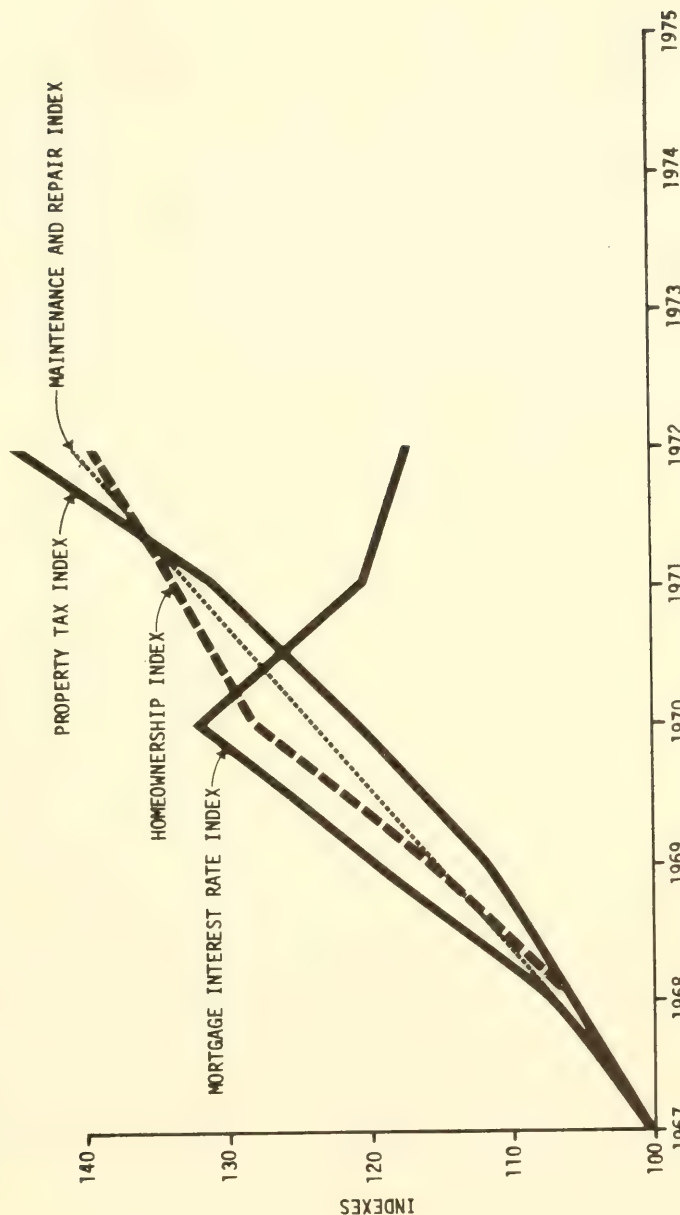
RELATIVE PRICES OF MORTGAGE AND OPERATING EXPENSES, 1963-1972

YEAR	RELATIVE PROPERTY TAX RATE	MORTGAGE INTEREST RATE	RELATIVE MORTGAGE INTEREST PAYMENTS	RELATIVE REPAIR & MAINTENANCE	RELATIVE UTILITY PRICE	RELATIVE PROPERTY INSURANCE
1963	NA	.90	.93	.96	1.07	.87
1964	.95	.89	.93	.96	1.06	.91
1965	.97	.90	.93	.97	1.04	.95
1966	.97	.95	1.02	.98	1.02	.97
1967	1.00	1.00	1.00	1.00	1.00	1.00
1968	1.01	1.07	1.11	1.02	.97	1.01
1969	1.02	1.20	1.25	1.05	.94	1.00
1970	1.04	1.32	1.37	1.07	.93	.98
1971	1.08	1.20	1.23	1.10	.95	.99
1972	1.16	1.18	1.22	1.12	.96	.98

NA = NOT AVAILABLE

SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, RELATIVE IMPORTANCE OF THE CONSUMER PRICE INDEX; HANDBOOK OF LABOR STATISTICS, 1972; MONTHLY LABOR REVIEW, FEBRUARY 1973.

CHANGES IN COMPONENTS OF HOMEOWNERSHIP COST, 1967-1972



SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, HANDBOOK OF LABOR STATISTICS, 1972, TABLE 127; MONTHLY LABOR REVIEW, FEBRUARY 1973, TABLES 24 AND 25.

abated somewhat. Also, revenue-sharing has provided state and local governments with an alternative to increasing property taxes, which may also reduce future tax rate changes.

OTHER COSTS: Other housing cost factors are property insurance and utilities.¹¹ As can be seen from Table 5, the relative cost of property insurance has increased at about the same rate as the overall price index in recent years while the relative price of utilities has declined by approximately 10 percent over the past decade. Up to 1972, neither of these factors has contributed much to the overall increase in the relative costs of homeownership. However, the current "energy crisis" probably indicates that utility costs will be rising much more rapidly in the future.

¹¹The "cost of homeownership" index includes neither utilities nor fuels. They are, however, part of the operating costs included in the broader "housing" index and, as with many "homeowner" costs discussed here, they probably affect renters as much as they do owners. If the cost of utilities and fuels were included in the cost of homeownership, the overall cost increase would be only 34.8 percent rather than 40.1 percent. This occurs because the cost of utilities and fuels has risen by only 21.6 percent since 1967.

THE IMPACT OF RISING HOMEOWNERSHIP COSTS ON HOUSEHOLDS

GENERAL HOUSEHOLD RESPONSE

The discussion in this section centers on the cost of owning a home; renters and rental costs are the special focus of a later section of this Chapter. To reiterate, during the 1967-1972 period homeownership costs rose especially rapidly -- about 40 percent. During the same period, however, the overall Consumer Price Index rose by only 25 percent while per capita disposable income increased by 39 percent. The implication of these data is that the typical American household has had several options available to it in adjusting to the increased cost of owning a home.

Theoretically, the improvement in living standards has permitted the average household to increase its housing consumption in the face of price increases. Alternatively, the household may have decided that more housing was not worth the price, choosing instead to devote its increased real income to other things while buying a smaller or lower quality house. Indeed, a household may decide to change radically the style of its housing by shifting to less expensive homes. In any case, such shifts represent the outcome of voluntary consumer decisions, except in the case of those families whose real income has lagged behind that of the rest of the population. The typical family has the resources to improve its quality of housing by spending a larger portion of its increased income on housing if it wishes to do so.

How the average household actually responds to higher housing costs is not completely understood. There is some limited evidence, however, that households recently have been buying smaller homes. The median square footage of floor area of a new, privately owned, single-family home purchased in 1972 was some 7 percent less than it was in 1967.¹²

Although this tendency towards smaller homes seems substantial, there are several reasons for believing that it considerably overstates any reduction in housing consumption attributable to increased housing prices, and that it will be reversed in 1973. For one thing, the years of greatest decline in home size, 1970 and 1971, are also the

¹²Department of Commerce, Bureau of the Census, Construction Reports, Sales of New One-Family Homes, Annual Statistics, 1967, C-25-73, Table 31; advance data from 1972 annual statistics.

years of most rapid growth in the Section 235 program for home acquisition by low- and moderate-income families, and in FmHA subsidized programs; some of the decline in median home size, therefore, is undoubtedly due to the building of many more, smaller, Section 235 and FmHA homes. Again, any burden represented by the actual reduction in housing size depends largely upon what households are being forced to pay for this housing. Evidence, developed later in this Chapter, indicates that most groups of households who are buying smaller homes are also paying less of their real incomes for them, leaving more of their incomes for other uses, including mortgage interest costs.¹³ Finally, a smaller size does not necessarily imply that the home is of lower quality. Buyers may be more than compensated by adding various amenities and there is some evidence that this is, in fact, what has happened.

In contrast to declining home size, statistics on annual home sales indicate that the number of new homes available nationally was expanded greatly during the period from 1967 to 1972; annual sales of new, single-family homes increased by over 47 percent, from 487,000 in 1967 to 718,000 in 1972.¹⁴ These statistics suggest that the heightened demand and its attendant price increases have induced a significant increase in housing supply.

Moreover, the annual volume of sales of existing, single-family homes showed a similar increase, with the number of sales in 1972 exceeding the 1967 figure by 61 percent.¹⁵ Although sales of existing homes do not contribute directly to the total supply of housing, an increase of this magnitude reveals an increasingly active resale market for houses; put another way, rising prices have in no way decreased the level of activity in the market place.

Judging from the substantially increased sales of new and existing homes since 1967, then, rising costs of owning a home do not appear seriously to have dampened general demand for housing. But housing is not uniform. Quality,

¹³Between 1969 and 1970, the average sales price of new, one-family homes declined by 4.7 percent, despite a 3.3 percent rise in the one-family house price index. U.S. Department of Commerce News, July 5, 1973. CB473-166. p. 2.

¹⁴Department of Commerce, Bureau of the Census, New One-Family Homes Sold and For Sale, Construction Report C25-73-2, February, 1973.

¹⁵National Association of Real Estate Boards, Department of Research, 1972 Annual Report.

for example, is variable, making it possible for households to offset rising costs by purchasing housing that has fewer amenities, if they wish.

HOUSING COST VS. HOUSING VALUE

Although no single measure is likely to provide an entirely accurate record of changes in housing quality, one relatively straightforward approach is to compare the year-to-year change in the cost of a standard house (as measured by an appropriate cost index) with the year-to-year changes in the price of housing that people actually buy. If the price of houses actually purchased goes up more than the cost of a standard house, it is assumed that quality improved, since people are buying a house that is more expensive than the standard quality house.

Table 6 makes such a comparison. The second column in Part 1 shows what the typical new 1963 single-family house insured by the FHA Section 203 program would have cost in each succeeding year. This is calculated by multiplying the 1963 price of the house by the increase in costs, measured by an FHA home purchase index. Because costs rose by 2.6 percent from 1963 to 1964, the typical 1963 house rose in cost by 2.6 percent, from \$15,789 to \$16,200. Similarly, the 2.2 percent cost increase from 1964 to 1965 would have further raised the cost of the "standard" 1963 house, from \$16,200 to \$16,555. The remaining entries are calculated in the same way.

Column 3 gives the median value of all new houses insured by FHA under Section 203 in each year. This is the most comprehensive information available about the value of the new houses which people actually bought. The 1963 value is also used as the benchmark value in Column 2 for 1963, to provide a ready basis of comparison of costs and values.

Columns 4 and 5 show how much more rapidly housing values increase; Column 4 is the dollar value of the difference and Column 5 is the percentage by which housing has improved. In 1972, for example, a new "typical 1963 house" would have cost \$23,907 but the median value of the house actually bought was \$24,665. This represents an improvement of \$758 or 3.2 percent. Put another way, the typical new house actually purchased in 1972 was worth 3.2 percent more than the typical new house purchased in 1963, even after cost increases are taken into account.

TABLE 6

FHA NEW HOUSING COSTS AND VALUES

PART I: 1963 BASE

YEAR	COST OF STANDARD HOME (NEW HOME PURCHASE INDEX)	MEDIAN VALUE NEW FHA 203 HOME	DIFFERENCE (VALUE-COST)	PERCENT CHANGE IN HOUSING QUALITY (DIFFERENCE/COST)
1963	\$15,789	\$15,789		
1964	16,200	16,063	-\$137	-.8
1965	16,555	16,561	6	.04
1966	17,207	17,163	-44	-.3
1967	18,085	17,992	-93	-.5
1968	18,682	18,797	115	.6
1969	19,839	20,213	374	1.9
1970	21,929	22,957	1028	4.7
1971	22,806	23,866	1060	4.6
1972	23,907	24,665	758	3.2

PART II: 1967 BASE

YEAR	COST OF STANDARD HOME (NEW HOME PURCHASE INDEX)	MEDIAN VALUE NEW FHA 203 HOME	DIFFERENCE (VALUE-COST)	PERCENT CHANGE IN HOUSING QUALITY (DIFFERENCE/COST)
1967	\$17,992	\$17,992		
1968	18,585	18,797	\$212	1.1
1969	19,737	20,213	476	2.4
1970	21,817	22,957	1140	5.2
1971	22,690	23,866	1176	5.2
1972	23,785	24,665	880	3.7

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

Part II of Table 6 takes 1967 as the base year and compares the value of new homes purchased in subsequent years to the cost of the "typical 1967 house." Between 1967 and 1972, the expenditures on new houses rose 3.7 percent more than the cost of the standard home providing some indication that a higher quality home was being purchased. In fact, the relative improvement since 1967 exceeds that since 1963 because "quality" appears to have declined slightly in 1966 and 1967. The evidence is weak because FHA's share of the market has been shrinking in recent years, and some statistical biases may have been introduced because of changes in the nature of the FHA market. On the other hand, if there had been major declines in the quality of houses purchased, one would expect to find some indication of the phenomenon, even in this somewhat deficient data.¹⁶

Applying the same technique to purchase of existing homes (Table 7), the picture is slightly different. "Quality" was 2.6 percent lower in 1972 than it was in 1967 and roughly the same as it was in 1963.

THE DIFFERENTIAL IMPACT OF COST CHANGES

To this point, the analysis has been based on highly aggregative data, dealing with the "typical" household or the "typical" homeowner. As in the case of the housing index and its components, however, averaging often conceals a great deal, thereby presenting a somewhat blurred picture. Succeeding sections of this Chapter provide information on the housing cost changes experienced by different subgroups of the population, to the extent that the available data permit. This section briefly considers the probable impact that the different rates of increase of homeownership cost components have had on different population subgroups. Renters will be discussed in a subsequent section.

¹⁶These statements strictly apply only to FHA houses used in the data. However, the same patterns occur for costs and expenditures on all new houses, according to data collected by the Department of Commerce, Bureau of the Census and published in the Construction Reports series. The Census data in the most recent years are somewhat affected by the large increase in volume of Section 235 houses which contribute to a slight downturn in housing values, but these data still show a 4 percent improvement in quality over the 1963-1972 period, which is close to that shown by the FHA data. Bureau of the Census, New One-Family Homes Sold and For Sale, Construction Report C25-73-2, February 1973.

TABLE 7

FHA EXISTING HOUSING COSTS AND VALUES

PART I: 1963 BASE

YEAR	COST OF STANDARD HOME (EXISTING HOME PURCHASE INDEX)	MEDIAN VALUE EXISTING FHA 203 HOME	DIFFERENCE (VALUE-COST)	PERCENT CHANGE IN HOUSING QUALITY (DIFFERENCE/COST)
1963	\$14,342	\$14,342		
1964	14,453	14,614	\$161	1.1
1965	14,882	15,128	246	1.7
1966	15,295	15,148	-147	-1.0
1967	15,438	15,828	390	2.5
1968	15,660	16,081	421	2.7
1969	16,661	16,617	-44	-.3
1970	17,487	17,773	286	1.6
1971	18,281	18,856	575	3.1
1972	19,726	19,691	-35	-0.2

PART II: 1967 BASE

YEAR	COST OF STANDARD HOME (EXISTING HOME PURCHASE INDEX)	MEDIAN VALUE EXISTING FHA 203 HOME	DIFFERENCE (VALUE-COST)	PERCENT CHANGE IN HOUSING QUALITY (DIFFERENCE/COST)
1967	\$15,828	\$15,828		
1968	16,056	16,081	\$25	.2
1969	17,082	16,617	-465	-2.7
1970	17,929	17,773	-156	-.9
1971	18,743	18,856	113	.6
1972	20,225	19,691	-534	-2.6

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.

For example, maintenance and repair costs increased particularly rapidly between 1967 and 1972. One would expect maintenance needs to rise with the age of the dwelling; correspondingly, one would expect maintenance costs to constitute a larger percentage of housing costs for an older dwelling, than for a newer one. Further, to the extent that older housing tends to be concentrated in the central city, the rising relative costs of maintenance services would seem to strike hardest at central city dwellers. Studies generally find residents of the central city to include large percentages of blacks, the aged, and female-headed families -- groups which, in turn, generally have a lower income than does the general population. In short, the major impact of rising housing maintenance costs may fall on the poor.

The direct impact of land cost increases, by contrast, is likely to fall on relatively high-income groups. Since most new construction tends to be in suburban areas, the increased price of new home sites is probably being paid by relatively well-to-do suburban households, rather than by low-income groups.

It is one thing, however, to identify who is paying the increased costs for a component of housing, although this is difficult enough; it is quite another thing to determine precisely how these increased housing costs affect any particular population subgroup. Increased land prices, for example, may make it more difficult for, say, low-income groups to become suburbanites. In this case, the low-income household would be adversely affected, albeit indirectly, by being less able to afford new suburban homes.

These implications of the increasing costs of land, and of maintenance, are consistent with the relatively slight reduction in the quality of the existing housing purchased by the typical household (Table 7). The reduction may reflect purchases by relatively low-income families of older, central city housing. This housing becomes increasingly less desirable as maintenance costs rise, because it is most likely to require maintenance; but at the same time, existing houses are bought because land price increases have made it still more difficult for low- and middle-income households to buy new, suburban housing.

HOUSING COST BY INCOME CLASS

To get a better understanding of how American households may have been affected by recent housing cost increases, it is useful to look at the housing expenditure patterns of various income groups (Table 8).

TABLE 8
NEW HOUSING CONSUMPTION BY INCOME GROUP*

	LOW			MEDIUM			HIGH		
	4-500 MONTHLY INCOME 1967	5-600 MONTHLY INCOME 1972	PERCENT CHANGE	7-800 MONTHLY INCOME 1967	9-1000 MONTHLY INCOME 1972	PERCENT CHANGE	10-11000 MONTHLY INCOME 1967	12-1400 MONTHLY INCOME 1972	PERCENT CHANGE
AVERAGE FAMILY INCOME	6591	8091	22.8	9640	12,171	26.3	13,204	16,243	23.0
MEDIAN TOTAL ACQUISITION	14,169	18,520	30.7	17,937	23,838	32.9	21,328	26,693	25.2
MEDIAN NUMBER OF ROOMS	5.1	5.1	-	5.72	5.78	1.0	6.27	6.16	-1.8
MEDIAN NUMBER OF BEDROOMS	2.95	2.90	-1.7	3.06	3.11	1.6	3.22	3.19	-0.9
PERCENT WITH MORE THAN 1 BATH	34.8	46.4	33.3	75.4	79.3	5.2	88.5	88.0	-0.6
MEDIAN FLOOR AREA	975	1020	4.6	1183	1206	1.9	1368	1342	-1.9
MEDIAN MONTHLY EXPENSE	126.19	184.88	46.5	168.83	243.14	44.0	199.70	276.15	38.3
MEDIAN EXPENSE/INCOME RATIO	27.8	33.2	19.4	22.6	25.7	13.7	19.2	21.4	11.5
MEDIAN AGE OF MORTGAGOR	27.6	27.8	0.8	30.8	29.0	-6.2	34.7	30.6	-13.4
MEDIAN TOTAL FIXED OBLIGATIONS	169.90	240.35	41.5	260.73	355.28	36.3	325.45	438.09	34.6
AVERAGE PRINCIPAL AND INTEREST	79.13	113.31	43.2	101.71	130.82	28.6	120.45	164.54	36.6
AVERAGE MORTGAGE INSURANCE PREMIUM	5.88	7.03	19.6	7.41	8.14	9.9	8.69	10.22	17.6
AVERAGE HAZARD INSURANCE	3.62	5.82	60.8	4.36	5.53	26.8	5.00	7.05	41.0
AVERAGE REAL ESTATE TAX	10.79	21.44	98.7	20.79	27.86	34.0	28.95	46.42	60.3
AVERAGE REPAIR AND MAINTENANCE	7.23	12.43	71.9	9.90	12.32	24.4	12.23	16.19	32.4
AVERAGE HEATING AND UTILITIES	19.52	25.41	30.2	24.93	26.83	7.6	28.56	32.96	15.4
AVERAGE OTHER RECURRING COSTS	51.30	60.12	17.2	94.45	88.88	-5.9	130.00	170.73	31.3

* NOTE: MONTHLY INCOME CLASSES ARE TOTAL EFFECTIVE MONTHLY INCOME NOT CURRENT INCOME. TOTAL EFFECTIVE INCOME IS THE FHA-ESTIMATED AMOUNT OF THE MORTGAGOR'S EARNING CAPACITY (BEFORE DEDUCTIONS FOR FEDERAL INCOME TAXES) THAT IS LIKELY TO PREVAIL DURING APPROX. THE FIRST THIRD OF THE MORTGAGE TERM.
SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, 1967 HUD STATISTICAL YEARBOOK, AND UNPUBLISHED DATA.

Examination of three income brackets -- low, medium, and high -- permits a comparison of the average new housing consumed by a typical family in 1967 with that consumed by a comparable family (one with the same real income) in 1972. Because the real income of typical buyers increased over the period, this approach overstates the impact of rising housing costs on most people. Also, the data are only for purchases of FHA-insured houses which introduces a further bias.¹⁷

The most severe increase in homeownership costs also occurred during this period. Table 8 permits one to see how families whose real income did not increase may have altered their consumption of new housing in response to increased housing costs. First, the median total acquisition cost of housing increased more for the low and medium groups than it did for the high-income group. (The increases are 30.7 percent, 32.9 percent and 25.2 percent, respectively.) The ratio of housing expenditures to income rose for all groups with constant real incomes, since monthly expense rose more rapidly than did money income. The increases in the ratio range from 10 percent to 20 percent. Second, the low and medium groups bought slightly larger houses in 1972, but the change is less than 5 percent for all measures of housing space. The high-income family, by contrast, bought a very slightly smaller house.

Table 9 presents the same information for buyers of existing houses. Again, the rate of increase of median monthly expenses outpaced increases in income, increasing the ratio of housing expense to income, but the increases are smaller than for buyers of new houses. Despite the increases, it appears that buyers in all three groups purchased about the same type house in 1972 as they did in 1967, although acquisition expenditures made by the low group increased by somewhat more than they did for the other two groups. (The respective percentage increases are 27.8,

¹⁷Unfortunately, there are few data on housing consumption by income class and there are some serious problems in using and interpreting the data that are available. For a brief discussion of these problems, see Appendix B to this Chapter. Also, the terms "low," "medium," and "high" income refer to the income classes which buy FHA-insured houses, rather than to all households. For example, about one-third of all families in 1972 were below the median income of the "low" FHA group, and about one-quarter were above the median for the "high" group.

TABLE 9
EXISTING HOUSING CONSUMPTION BY INCOME GROUP *

	LOW			MEDIUM			HIGH		
	3-500 MONTHLY INCOME 1967	5-600 MONTHLY INCOME 1972	PERCENT CHANGE	7-800 MONTHLY INCOME 1967	9-1000 MONTHLY INCOME 1972	PERCENT CHANGE	10-1100 MONTHLY INCOME 1967	12-1400 MONTHLY INCOME 1972	PERCENT CHANGE
MEDIAN FAMILY INCOME	6122	7693	25.7	9740	12,269	26.0	13,205	16,358	23.9
MEDIAN TOTAL ACQUISITION	10,712	13685	27.8	16,632	20,214	21.5	19,434	23,897	23.0
MEDIAN NUMBER OF ROOMS	5.05	5.08	0.6	5.72	5.58	-2.4	6.06	5.92	-2.3
MEDIAN NUMBER OF BEDROOMS	2.46	2.55	3.7	2.97	2.94	-1.0	3.08	3.04	-1.3
PERCENT WITH MORE THAN 1 BATH	11.8	14.2	20.3	45.0	44.3	-1.6	64.1	58.7	-8.4
MEDIAN FLOOR AREA	930	946	1.7	1165	1125	-3.4	1318	1237	-6.1
MEDIAN MONTHLY EXPENSE	112.58	156.85	39.3	164.59	220	33.7	189.31	255	34.8
MEDIAN EXPENSE/ INCOME RATIO	26.8	28.4	6.0	22.2	23.2	4.5	18.2	19.8	8.8
MEDIAN AGE OF MORTGAGOR	27.1	26.2	-3.4	31.7	29.6	-7.1	35.0	31.9	-9.7
MEDIAN TOTAL FIXED OBLIGATIONS	164.03	228.81	39.5	255.22	349.80	37.1	321.98	425.67	32.2
AVERAGE PRINCIPAL AND INTEREST	63.80	88.75	39.1	93.49	126.42	35.2	110.27	146.68	33.0
AVERAGE MORTGAGE INSURANCE PREMIUM	4.72	5.42	14.8	6.75	7.79	15.4	7.91	9.05	14.4
AVERAGE HAZARD INSURANCE	3.27	4.51	37.9	3.96	5.52	39.4	4.44	6.17	39.0
AVERAGE REAL ESTATE TAX	13.64	20.02	46.8	24.96	35.18	40.9	30.71	44.77	45.8
AVERAGE REPAIR AND MAINTENANCE	7.52	10.99	46.1	9.43	13.49	43.1	11.01	15.12	37.3
AVERAGE HEATING AND UTILITIES	20.47	28.23	37.9	24.90	32.16	29.2	27.70	35.31	27.5
AVERAGE OTHER RECURRING COSTS	56.54	75.58	33.7	98.37	132.46	34.7	136.27	174.39	28.0

*TOTAL EFFECTIVE MONTHLY INCOME

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, 1967 HUD
STATISTICAL YEARBOOK, AND UNPUBLISHED DATA.

21.5, and 23.0.) The low group also bought a slightly larger house, while the other groups bought slightly smaller ones.¹⁸

While the changes in housing expenditures and sizes are very similar for all income groups, there are slight differences. Some groups have elected to buy slightly larger houses, paying slightly more for them; others have chosen to buy slightly smaller ones, paying slightly less. But all groups are buying just about the same size house, at just about the same relative price, as they did in 1967.

Tables 8 and 9 also tend to indicate that the typical house in each income class was of about the same quality in both years, as well as the same size. For most income brackets, the percentage of houses having more than one bathroom changed by a few percentage points. However, the proportion of low-income buyers of new housing with more than one bathroom increased by over 33 percent, with the percentage of such houses rising from 34.8 percent in 1967 to 46.4 percent in 1972. Other characteristics of houses also changed over this period; on the one hand, more houses had garages in 1972 but, on the other, fewer had full basements. Unfortunately, information on these and other quality characteristics is not available by income class for either year.

The findings of Tables 8 and 9 are generally consistent with those of Tables 6 and 7. Table 6 showed that people typically have bought better new houses in the most recent years; this is to be expected, since the average real income was rising throughout this period. In Table 8, however, an examination of typical new houses bought by families having about the same real income throughout the 1967-1972 period shows that they are buying about the same size house even though relative prices have increased, and the home purchase has required a larger proportion of their income. To the extent that these statistics on hypothetical families are indicative of the housing consumption patterns of groups with unchanged real income, it would seem that the groups studied

¹⁸Earlier it was noted that the average house purchased declined in size between 1967 and 1972. It was argued that this result may have been the result of the Section 235 program which increased the production of smaller houses. The data used in this section refer only to houses purchased under the 203 program and so exclude any direct impact of the Section 235 program. However, the fact that poorer people are on average moving to larger houses may reflect the indirect effect of Section 235 making more housing available to low- and moderate-income groups.

here have reacted to rising housing costs not by buying less housing, but by buying less of other goods. Of course, it should be remembered that a relatively small number of families experienced no increase in real income during this period.

For buyers of existing houses, there was no improvement in housing either for the family shown in Table 7 or for the real income classes shown in Table 9. These findings are consistent, because the median real income of the buyers of existing FHA houses showed virtually no increase over the period (2.7 percent in 5 years). In other words, a comparison of typical FHA buyers of existing homes is almost the same as a comparison of FHA buyers having the same real income. This differs from the situation for FHA buyers of new homes; the typical FHA buyer of a new home enjoyed a real income in 1972 which was 9.2 percent higher than that of the typical FHA buyer 5 years earlier.

Finally, these tables point out, again, that an increased purchase price of houses is only partially responsible for the recently accelerated rise in homeownership costs. The costs of other factors are rising even more rapidly. Mortgage payments, taxes, maintenance expenses, and insurance premiums -- all typically show increases of 20 to 30 percent, and often much more, between 1967 and 1972. These increases are roughly similar to those in the Consumer Price Index.

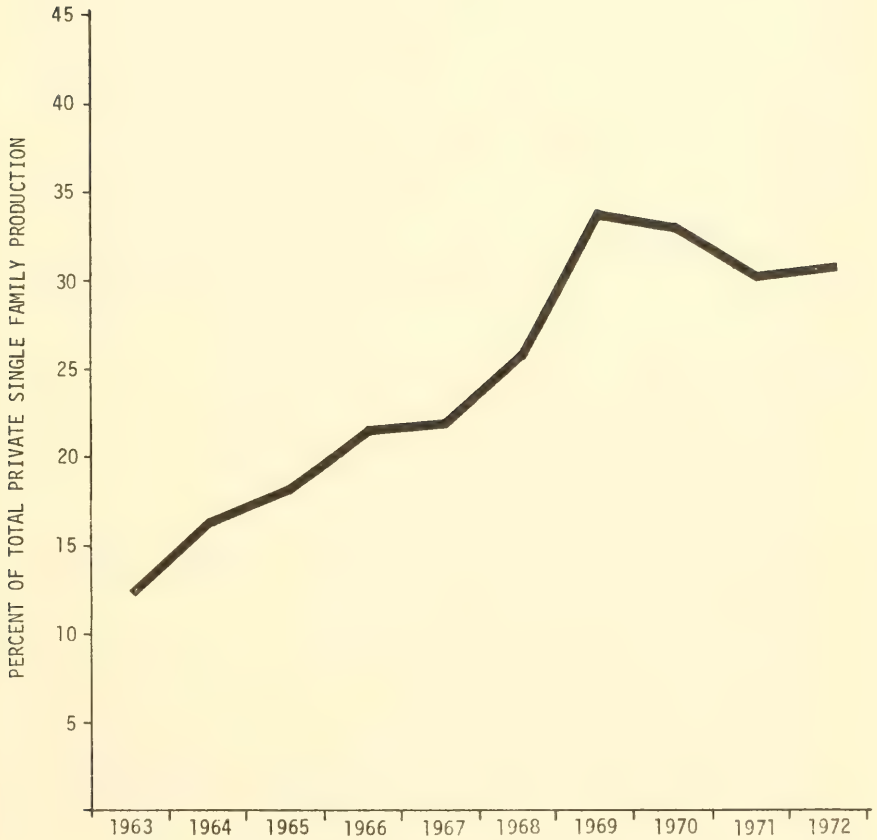
HOUSING COSTS AND MOBILE HOMES

Increased housing costs are partly responsible for the tremendous growth in the demand for mobile homes. The mobile home share of the occupied year-round housing market has increased substantially since 1950. Mobile homes then constituted less than 1 percent of the occupied year-round units, but by 1970 this had grown to 3 percent. In 1972 mobile home shipments constituted 19.5 percent of all new units and 30.5 percent of all new single-family units (Chart 4).

The increasing importance of mobile homes as a source of year-round housing has been accompanied by drastic changes in their physical features as well as in the market for them. They are rapidly becoming more competitive with some conventional homes. For example, 8-foot wide mobile homes were the rule until 1955 when 10-foot wides were introduced. Twelve-foot wides came into mass production in 1962, and by 1970 comprised almost 80 percent of mobile home sales. Fourteen-foot wides, first available in 1969, already constituted 19 percent

CHART 4

MOBILE HOME SHIPMENTS AS PERCENT OF PRIVATE SINGLE FAMILY
STRUCTURES STARTED PLUS MOBILE HOME SHIPMENTS



SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CONSTRUCTION REPORTS, C 20, TABLE 8.

of the mobile home market by 1972.¹⁹ While growing in size, mobile homes have also been increasing in durability, with life expectancy increasing from about 10 years for those produced prior to 1955 to 14 years or more for those produced after 1958.²⁰ (Their durability, or course, also depends on the amount of care and maintenance mobile homes receive, as well as on the wear and tear inflicted by residents.) The average sale price of a mobile home about doubled between 1950 and 1971, rising from \$3,000 to \$6,640. Because of increasing size, however, the cost per square foot of mobile homes declined from an average of about \$11 in 1960 to \$8.73 in 1972. This contrasts sharply with an average cost per square foot of \$15.68 for conventional housing (Chart 5).²¹

The mix of construction costs for a mobile home also differs markedly from what it is for a conventional house. For conventional homes, construction costs break out as follows: 38 percent for materials; 40 percent for labor; and 22 percent for overhead, operating expenses and profit. For mobile homes, the comparable figures are 66 percent, 12 percent, and 23 percent.²² The much lower labor cost component of mobile home manufacturing is the result of the use of assembly line techniques and semi-skilled labor. The cost of materials is a more significant portion of mobile

¹⁹The large double and triple-wides, counted as one unit (two and three mobile homes jointed horizontally on the site but shipped separately), and expandables now account for about 15 percent of the mobile home market. (By way of contrast, less than 1 percent of the mobile homes sold today are 8-foot wides or 10-foot wides.)

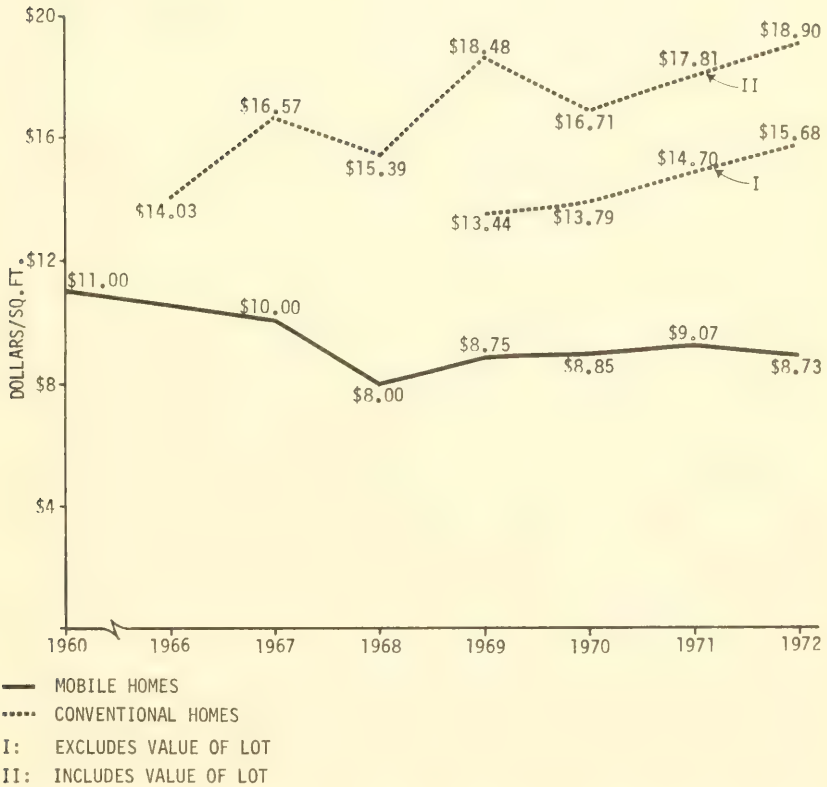
²⁰Mobile Home Manufacturers Association, Mobile, Sectional and Modular Homes, June, 1972. The increase in length of loans tends to confirm this.

²¹Mobile home prices per square foot are strictly comparable only with those for conventional homes as represented by Curve I in Chart 5 in that neither includes the value of the lot, and its improvements, in sales price. This sales price statistic is available for conventional homes only since 1969. Curve II permits a longer-term comparison of price trends, even though it contains the upward bias from including improved-lot value in sales price.

²²"Mobile Housing Manufacturer's Cost and Profit Survey," Mobile-Modular Housing Dealer Magazine, 1972.

CHART 5

COSTS PER SQUARE FOOT FOR MOBILE AND CONVENTIONAL HOMES



SOURCE: MOBILE HOME MANUFACTURERS ASSOCIATION; DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CONSTRUCTION REPORTS, C25-71-B, C25-73-3.

home construction costs, but increases in material costs between 1967 and 1972 have been less than increases in the cost of labor. Moreover, because mobile homes are not subject to building codes, manufacturers have been able to utilize new technology, volume production and lower standards -- all of which tend to reduce production costs.

A significant portion of the purchaser's cost of a mobile home is the financing charge. While savings and loan associations may make conventional home mortgage loans for mobile homes, about 90 percent of the retail financing is handled through commercial banks and finance companies where they are financed with chattel mortgages, the same way that automobiles are financed. They are generally considered consumer durables by financial institutions.

Financing terms have been liberalized since the 1950's when a 33 percent downpayment was required, and loans were made for 3 years at 7 percent add-on interest. Typical terms now involve 20 percent down, 9 year loans (12 years for larger mobile homes or with FHA-insured or VA-guaranteed loans) at 7 or 7 1/2 percent add-on interest. The add-on method of quoting interest may be misleading to those who are unfamiliar with this technique since interest is calculated on the full amount of the loan until the loan is fully retired. This results in a true interest rate almost double the stated add-on rate. (Truth-in-lending legislation requires the disclosure of the actual rate of interest.) For the first 6 months of 1973 the actual rate was 11.52 percent. As an example of the differences between methods of computing interest, a conventional \$1,000 loan for 10 years at 7 percent interest results in total interest charges of \$435 but the same loan at 7 percent add-on interest yields \$700 in interest charges over the 10 year period. While mobile homes may be more expensive to finance than are conventional homes, mobile home financing historically has not been as severely affected by the periods of tight credit which afflict mortgage markets. Mobile home financing is less sensitive to monetary and fiscal policy changes.

Site rental is another important component of monthly mobile home housing costs. Average monthly site rental increased from \$33 in 1967 to \$55 in 1972, a 67 percent increase for the period. Part of this increase can be explained by changes in mobile home parks and the increase in the cost of land and its development. Newer mobile home parks are now usually more than places which merely provide a pad on which to place a mobile home. Most new parks have paved and lighted streets; are landscaped; and provide

recreational and community facilities such as community centers, swimming pools, laundries and tennis courts.

In addition to site rental, many mobile home parks charge substantial entry and/or exit fees and they often charge extra for children and pets. (Entry fees of \$1,000 were reported in 1972 in New York parks.) Because these charges are not standard, they cannot easily be estimated on a monthly basis.

The cost of providing utility and maintenance service to the mobile home, as well as tax levies on it, have increased at about the same rate as they have for most types of housing. However, these costs typically do not loom large in overall mobile home housing costs and, to some extent, increases reflect the availability of increased and/or improved services to mobile home occupants.

The cost of utilities increased from an average of \$18 per month in 1967 to \$23 per month in 1972; the cost of repair and maintenance of mobile homes increased from about \$3 in 1967 to an estimated range of \$5 to \$6.25 per month in 1972.

Mobile homes receive differing tax treatment in the various States. Some States levy no taxes whatsoever (using annual license fees in lieu of taxes) while others impose personal property or real estate taxes. Due to their lower cost and relatively rapid depreciation, even in areas where real estate taxes are levied mobile home dwellers generally pay less in taxes than do conventional homeowners. Estimates of monthly mobile home taxes for 1972 range from \$5 to \$9 compared to almost \$40 per month for a conventional single-family home financed under FHA's Section 203 program.

There are several other cost factors of mobile homes which must be considered. Mobile homes have a much lower life expectancy than do conventional homes and, therefore, must be replaced relatively frequently. Due to their extreme flammability, when mobile home fires occur, the damage is usually great. The chance of death in a mobile home fire is six times greater than for a conventional home fire, and the loss-to-value ratio is over four times that for a conventional home.²³

²³Department of Health, Education, and Welfare, Division of Community Injury Control, Report on The Risk of Fires in Mobile Homes, p. 2; Office of Economic Opportunity, Mobile Homes and Low-Income Rural Families, p. 31.

Finally, mobile homes depreciate to only a small fraction of their original cost after 10-15 years while most conventional homes appreciate in value. This means that while the short term costs of purchasing and occupying a mobile home may be lower than comparable costs for conventional homes, in the long run there is a cost involved which either is not considered by or is irrelevant to mobile home purchasers. Over 25 percent of mobile home owners have incomes under \$4,000. These families are able to purchase mobile homes because of their lower selling price but may be unable to purchase conventional housing.

If recent trends in housing costs continue, the shift to mobile homes can be expected to continue. The reasons are clear; the primary factors contributing to the increased cost of conventional housing are the very same factors which have helped make mobile home prices so competitive, and mobile homes have adapted themselves well to match the increased demand, through increased size, reduced cost per square foot, increased life-expectancy, and declining finance costs.

The cost of construction labor has been rising rapidly in recent years, but labor comprises a relatively small component of mobile home construction costs; maintenance costs are rising rapidly at the same time that maintenance needs for mobile homes decline as their life expectancy increases; and, with land costs for new housing sites rising rapidly, mobile homes have a further advantage because they require a smaller lot than do conventional houses.

As land prices continue to rise, the advantage of mobile homes increases. Actual site rentals paid, however, may be increasing more rapidly than land costs, because mobile home parks are increasingly providing additional facilities, such as laundromats, tennis courts, and swimming pools. The newer mobile home parks are thus similar to the newer apartment complexes.

Paralleling the marked increase in production and use of mobile homes in recent years has been the extraordinary development of the condominium concept of homeownership. Condominiums increased from 11 percent of total housing built for sale in 1970 to 30 percent in 1972 and, in 1973, it is projected that condominiums will account for over one-half of all units built for sale in this country. This increased popularity of condominiums undoubtedly owes in part to the favorable tax treatment of homeowners under current income tax provisions. However, the growth of condominiums is also

partly due to the recently accelerated rise in homeownership costs. In particular, this type of housing saves on land costs and economizes on maintenance and repair expenses.

GEOGRAPHIC PATTERNS OF HOMEOWNERSHIP COST CHANGES

In addition to observing the housing cost and consumption patterns of different income groups, it is useful to examine how housing costs vary on a geographical basis. Because the national housing market is really a set of geographically separate and distinct local markets, housing costs can vary significantly among regions or cities for many reasons.

For one thing, resources used to produce housing services are not available at the same prices in all parts of the country. Such prices would be uniform everywhere only if the resources were easily moved between regions in response to price differences. Although some housing inputs (e.g., raw materials) are fairly mobile, others are not. Workers often have strong ties to the city or locality in which they live and will move only if wage differentials become very large; land is entirely immobile. Also, regional cost variations can result from differences in the kinds of housing services that are wanted in different areas; a rise in the price of central air conditioning, for example, would contribute more to housing cost increases in the South than elsewhere.

All parts of the country have faced greatly increased housing costs in recent years, but some areas have been harder hit than others. All available evidence indicates that new home prices have risen most rapidly in the Northeast and least rapidly in the Western States, with the relative rises in the South and Midwest somewhere in between, depending on the measure of housing cost used. The Census index of new home prices, for instance, rose by 44 percent in the Northeast from 1967 to 1972, compared to 31 percent in the South, 27 percent in the Midwest, and 25 percent in the West. Prices of new houses insured by FHA rose by 41 percent in the Northeast, 35 percent in the Midwest, 30 percent in the South, and 20 percent in the West, in about the same period. Some data on rents are also available; these will be analyzed in a later section of this Chapter.

In addition to regional differences, housing costs also vary by the size of the housing market. The Bureau of Labor Statistics has begun to publish a Consumer Price Index based on the size of the urban area; this index has been

calculated for five size groups for the period since 1967. It shows that housing costs are higher in the larger urban areas, and are lowest for the smallest size group -- urban areas with populations between 2,500 and 50,000. These figures are similar to those for the overall Consumer Price Index by size. Data on the components of the housing index are not available by size of urban area.

In 1972, housing costs for the smallest size group were 26.5 percent higher than they had been in 1967; costs for the largest size group (metropolitan areas with more than 3.5 million people) were 31.4 percent higher.

This index does not include a separate category for rural areas, and there are no comprehensive cost data available for these areas. In the absence of data, it is not appropriate to extrapolate from the trend of housing costs by size class, and assume that costs are lowest in rural areas. It is probable that mortgage interest rates in rural areas are about the same as those in the lowest size class of urban area; both may face higher rates than prevail in larger metropolitan areas.²⁴

Cost information on particular local areas is difficult to come by; in general, the smaller the geographical area, the scantier and less reliable are the housing cost data. However, the available data do confirm the general picture just outlined.

Perhaps the best source of local data on home costs is the Office of Technical and Credit Standards Division of the Federal Housing Administration, which each year collects information on the cost of building a typical house in each of the 177 FHA areas. For many areas, these houses have had the same basic characteristics since 1967 -- the same floor space, the same number of rooms, and the same building materials.

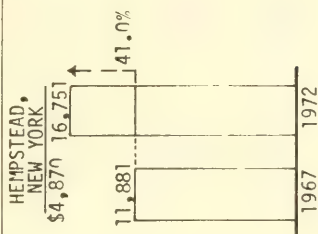
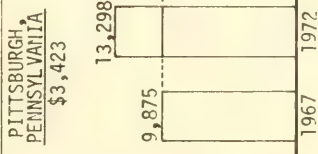
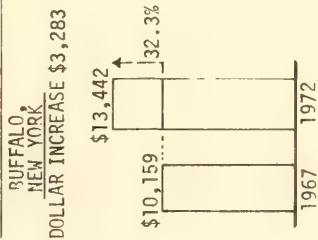
Changes in the cost of 42 such typical houses, located all over the country -- in big cities, small cities, and suburbs -- have been calculated as part of this study for the period 1967-1972. (Chart 6 shows the changes for all 42 areas, arranged by region; Appendix C contains a descrip-

²⁴E. Quinton Gordon, Emily A. MacFall, and Edna Hopkins, "Trends in Rural Non-SMSA Housing, 1950-1970," report for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

CHART 6
TOTAL DOLLAR AND PERCENTAGE INCREASE OF CONSTRUCTION COSTS
COMPARISONS OF MAJOR AND SMALLER CITIES, BY REGION, 1967-1972

NORTHEAST

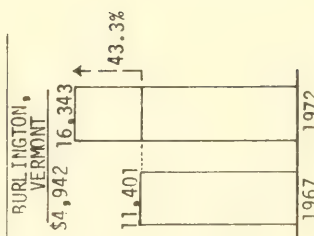
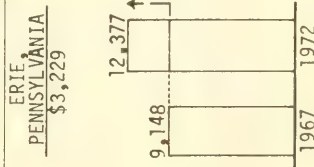
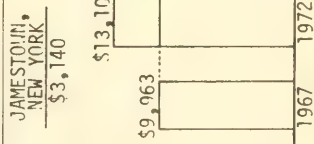
MAJOR CITY



COMPARABLE CITY
NOT AVAILABLE

1967 1972

SMALLER CITY



COMPARABLE CITY
NOT AVAILABLE

1967 1972

CHART 6 (CONTINUED)

TOTAL DOLLAR AND PERCENTAGE INCREASE OF CONSTRUCTION COSTS COMPARISONS OF MAJOR AND SMALLER CITIES, BY REGION 1967-1972 NORTH-CENTRAL

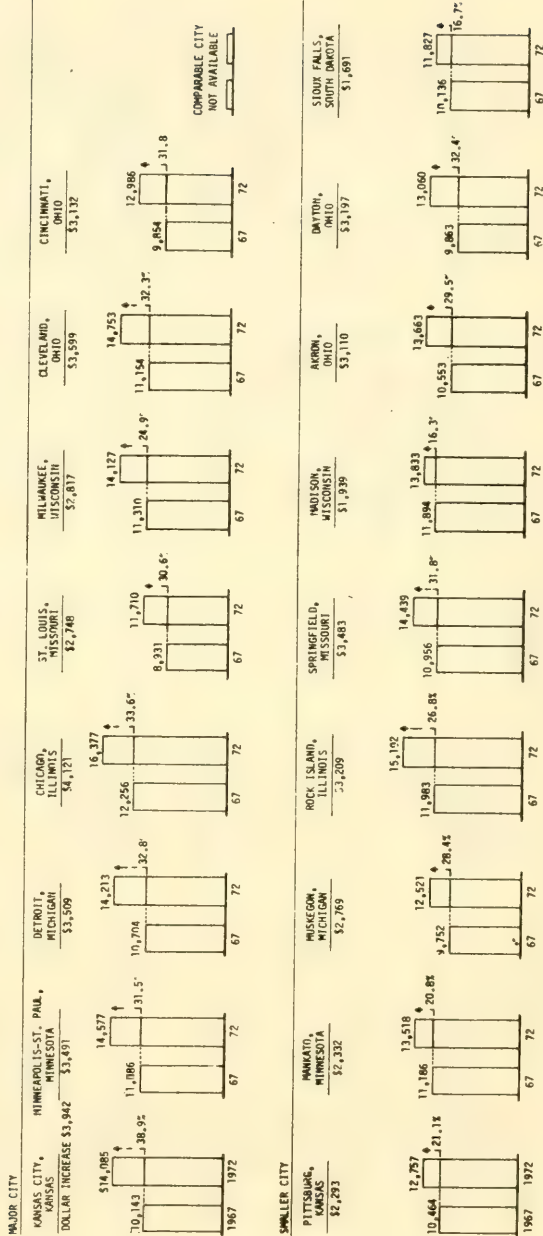


CHART 6 (CONTINUED)

TOTAL DOLLAR AND PERCENTAGE INCREASE OF CONSTRUCTION COSTS COMPARISONS OF MAJOR AND SMALLER CITIES, BY REGION 1967-1972 SOUTH

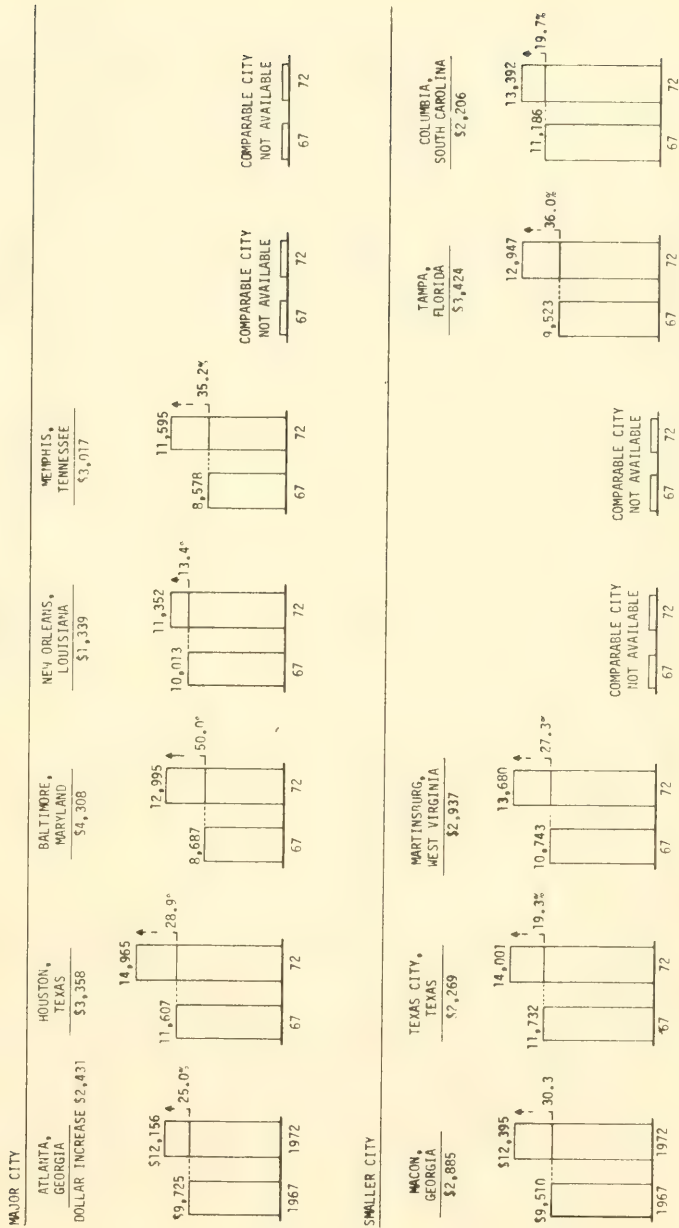
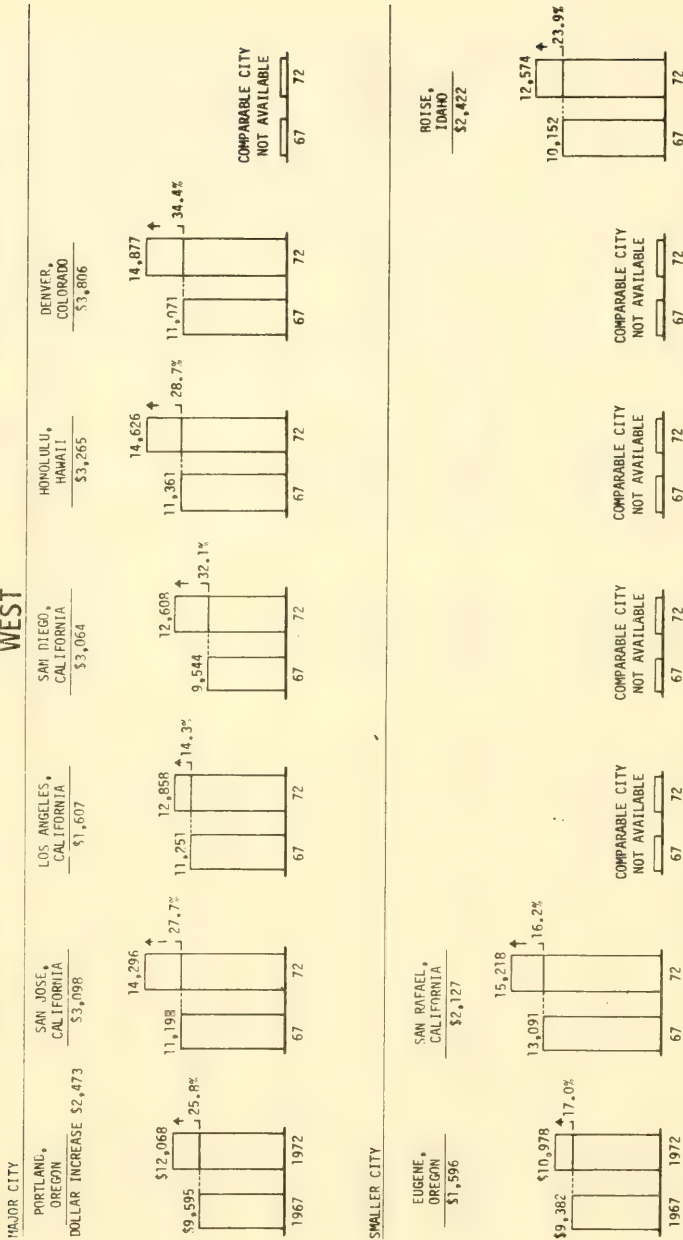


CHART 6 (CONTINUED)
TOTAL DOLLAR AND PERCENTAGE INCREASE OF CONSTRUCTION COSTS
COMPARISONS OF MAJOR AND SMALLER CITIES, BY REGION 1967-1972



SOURCE: MCKINSEY AND COMPANY, INC., "ANALYZING TRENDS IN HOUSING CONSTRUCTION AND OPERATING COSTS," A STUDY FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, 1973.

tion of the cost data.) Houses in the Northeast showed the largest increases, significantly higher than any other region; the Northcentral, South and West, followed in that order, closely bunched.

When homeownership costs in individual areas are examined, other patterns emerge. As occurred with the housing component of the Consumer Price Index, prices in large metropolitan areas have increased more rapidly than in nearby smaller Standard Metropolitan Statistical Areas, or in small cities. The increase was 29 percent in Houston, and only 19 percent in nearby Texas City, for example. Portland, the largest metropolitan area in Oregon, showed an increase of 26 percent; Eugene, the second largest, only 17 percent. In most instances, the differences were small -- about 32.3 percent in Buffalo and 31.5 percent in nearby Jamestown; 25 percent in Milwaukee, 16 percent in Madison. In a few instances, the smaller area experienced greater increases; prices rose slightly more rapidly in Erie than in Pittsburgh, and in Dayton than in Cincinnati.

The rate of growth of the area also appears to be related to the rate of cost increase. Small cities such as Mankato, Minnesota, and Pittsburg, Kansas, showed low increases; they are also among the lowest in population growth. The very lowest price increases, however, were in New Orleans and Los Angeles, which grew rather rapidly.

These figures measure only the change in the cost of the structure. Data on land prices are available for many of the same areas, although not for all of them. Land prices show patterns somewhat similar to those of structure prices; they have risen most rapidly in the East, for example, and are rising more rapidly in larger, faster growing areas. Again, there are exceptions: Chicago has a low price increase; Boise, Idaho, a high one.²⁵

When the change in the price of the typical lot is added to the change in the price of the typical structure, roughly the same pattern emerges. Price increases have been most rapid in the East, least rapid in the South.

²⁵The land price data are based on FHA-insured homes, and are averages of prices of sites actually sold. They may not accurately represent changes in the cost of the same type of land over time, since there is no attempt to compensate for differences in location, accessibility, or other characteristics. (See Appendix D for details.)

The question of who is being affected the most, then, by rising housing costs can be answered on a geographical basis, as well as on the basis of income. Table 10 compares changes in per capita income with changes in structure costs, land prices, and land and structure costs combined.²⁶

Structure prices outran income in only four areas, out of 39 for which the comparison could be made: Burlington, Baltimore, Cleveland, and Muskegon.²⁷ In four others, both grew at the same rate: New York, Chicago, Gary, and St. Louis. These areas tend to be concentrated in the Northeast and North Central regions, and tend to be larger.

The pattern for land prices is very different. Eight of 26 areas show price increases greater than income increases; four were in the West (Boise, Honolulu, Los Angeles, and Portland), with the others scattered. Another Western city, San Jose, had land prices increase as rapidly as income. (Land price data are available for fewer areas than are structure price data.)

When land and structure prices are combined, only four cities show price increases greater than income increases: New York, Detroit, Los Angeles, and Portland, Oregon. For all other areas, families are able to buy the same house, on the same size lot, that they could have bought in 1967, without having to reduce their consumption of other goods and services.

There is no especially clear geographical pattern in this, although there is a tendency for larger areas to incur greater cost increases, relative to income increases, than smaller areas do.

²⁶Per capita income by city is published in the Survey of Current Business; however, the most recent data available are for 1971. Consequently, Table 10 compares price changes from 1967 to 1972 with income changes from 1966 to 1971. It is unlikely that the conclusions would change significantly if exactly the same periods were compared. The income figures are total per capita rather than disposable, which are not available for individual areas. However, the ratio of disposable to total per capita income for the Nation as a whole changed by less than 1 percent from 1966 to 1971, so a comparison of costs with disposable income should show virtually the same patterns.

²⁷Income figures were not published for 3 of the 42 areas.

TABLE 10
CHANGES IN HOME COSTS & INCOMES BY METROPOLITAN AREA, 1967-1972

AREA	PERCENTAGE INCREASE IN			
	STRUCTURE COST	LAND COST	COMBINED COST	PER CAPITA INCOME (66-71)
<u>NORTHEAST</u>				
BUFFALO	32			39
BURLINGTON	43			39
ERIE	35			37
NEW YORK (HEMPSTEAD)	41	51	43	41
PITTSBURGH	35	25	32	37
<u>NORTH CENTRAL</u>				
AKRON	30			36
CHICAGO	34	7	27	34
CINCINNATI	32	10	26	38
CLEVELAND	32			30
DAYTON	32	25	30	32
DETROIT	33	53	38	34
GARY	27	24	26	27
KANSAS CITY	39	15	34	40
MADISON	23			36
MILWAUKEE	25			32
MINNEAPOLIS-ST. PAUL	32	36	33	38
MUSKEGON	28			26
ROCK ISLAND	27			29
SIOUX FALLS	17			65
SPRINGFIELD, ILL.	32			50
ST. LOUIS	31	16	27	31
<u>SOUTH</u>				
ATLANTA	25	14	22	49
BALTIMORE	50			41
COLUMBIA	20	59	27	48
HOUSTON	29	25	28	47
MACON	30			56
MEMPHIS	35	36	35	46
NEW ORLEANS	13	37	21	33
TAMPA	36	26	34	56
TEXAS CITY	19	24	20	48
<u>WEST</u>				
BOISE	24	58	30	43
DENVER	34	15	30	51
EUGENE	17	12	16	35
HONOLULU	29	67	48	49
LOS ANGELES	14	75	36	34
PORTLAND	26	74	37	35
SAN DIEGO	32	39	35	41
SAN JOSE	28	37	31	37
SAN FRANCISCO-OAKLAND (SAN RAFAEL)	16	32	21	38

SOURCE: DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; DEPARTMENT OF COMMERCE, SURVEY OF CURRENT BUSINESS, MAY ISSUES.

All of the geographical data discussed so far concern home purchase price only. In addition, the Consumer Price Index includes information on the "cost of homeownership" in large metropolitan areas. In 15 of the 18 areas for which comparisons are possible, the cost of homeownership increased faster than the cost of the typical house (structure only). The exceptions were Baltimore, St. Louis, and Cleveland; and, in all three areas, the difference was less than 2 percentage points. For 14 areas, land price estimates were also available, so that an overall cost of the house, including land, can be compared to the cost of homeownership. Again, the cost of homeownership outpaced the cost of the house in all but three areas: Los Angeles, San Diego and Honolulu. In these three areas, rapid increases in land prices explain the greater increase in the cost of a house.

The comparison between the increased cost of homeownership and the increase in per capita income is confined to the period 1967-1971 because income data are not available on a regional basis for 1972. Over this period, the cost of homeownership increased more rapidly than did per capita income in nearly all metropolitan areas: The four exceptions were Atlanta, Buffalo, Honolulu, and Washington, D.C. (Table 11).²⁸

When these data are considered together, the local patterns are very similar to the national one: Incomes have increased more rapidly than has the cost of a house, but the cost of homeownership (including mortgage payment, property taxes, and maintenance expenses) has increased more rapidly than either. People in nearly every part of the country can afford to buy as good a house as they could 5 or 6 years ago, and still have more left over to spend on other goods and services; but they have had to pay relatively more for the other total costs of homeownership. In most major metropolitan areas, while the house is not more of a burden, the maintenance and taxes are.

HOUSING COSTS FOR RENTERS

RENTS VS. HOMEOWNERSHIP COSTS

This Chapter has concentrated on the costs of owning a home, partly because there are much more detailed data

²⁸These figures would be very slightly changed if disposable income were used rather than total income; the ratio of disposable to total income changed by less than 1/2 percent from 1967 to 1971.

TABLE 11

CHANGES IN INCOME AND HOMEOWNERSHIP COSTS, 23 MAJOR SMSA'S^{*} 1967-1971

SMSA	PERCENTAGE CHANGE IN CPI	PERCENTAGE CHANGE IN HOME OWNERSHIP COMPONENT OF THE CPI	PERCENTAGE CHANGE IN PER CAPITA INCOME
ATLANTA	21.7	36.9	40
BALTIMORE	23.4	43.9	33
BOSTON	22.7	38.1	33
BUFFALO	21.8	28.6	31
CHICAGO	20.8	30.1	28
CINCINNATI	20.7	33.5	29
CLEVELAND	22.8	26.2	25
DALLAS	21.3	39.1	28
DETROIT	21.7	41.4	31
HONOLULU	18.9	25.8	39
HOUSTON	20.9	37.4	34
KANSAS CITY	20.5	32.8	30
LOS ANGELES	18.5	28.6	27
MILWAUKEE	20.1	29.8	25
MINNEAPOLIS	21.7	34.6	29
NEW YORK	25.9	44.2	31
PHILADELPHIA	23.5	37.1	28
PITTSBURGH	21.5	36.7	29
ST LOUIS	19.6	26.1	24
SAN DIEGO	19.8	40.4	29
SAN FRANCISCO	20.1	31.6	30
SEATTLE	16.4	28.7	13
WASHINGTON	22.7	32.9	35

* STANDARD METROPOLITAN STATISTICAL AREAS

SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, MONTHLY LABOR REVIEW, APRIL 1973, TABLE 26; DEPARTMENT OF COMMERCE, SURVEY OF CURRENT BUSINESS, MAY 1973, TABLE A.

available on the various cost items involved in homeownership than in renting, and partly because the cost of homeownership has been increasing much more rapidly in recent years. Rental costs have increased much less rapidly than income, even in the past 5 years, and less rapidly than the overall Consumer Price Index. Thus renters generally have not been adversely affected in recent years, although rising rents obviously are a problem for those whose incomes have not kept pace, just as higher prices for other goods and services are a problem. This is particularly significant since renters tend to cluster toward the lower end of the income distribution.

The sharp differences between the movements in rent and homeownership costs, however, are themselves important. The discrepancies are perhaps somewhat surprising, since would-be home buyers can typically choose to rent rather than buy when the cost of buying increases. The rapid rise in homeownership costs should, therefore, have induced some families to seek rental units, driving up rents and gradually bringing the two indexes closer together. There is, however, no evidence that this has been happening in recent years; if anything, the spread between them is widening.

It is difficult to find any factor in the rent index itself which would be likely to account for the difference. The rent index is calculated by comparing rent changes for the same apartment from month to month and year to year. Since the apartments are the same, most aspects of housing quality are automatically held constant over time; each apartment has the same number of rooms and bathrooms, the same floor area and the same amenities each time it is priced. The rent index is thus more precise than the home purchase index, since the latter is based on the prices of different houses from month to month. While the home purchase index does attempt to standardize for several dimensions of housing, it cannot be as precise as the rent index, since houses differ in many ways besides those taken explicitly into account in the home purchase index.

There is, however, one way in which the rent index is less precise than the home purchase index. Each year, the apartments included in the index sample are one year older; during that year, they may have depreciated. No attempt is made in the rent index to adjust rents for depreciation; depreciation appears in the index as a decline in price, rather than as a decline in quality. For this reason, many

statisticians regard the rental price index as inherently biased downward.²⁹

This problem does not arise for the home purchase index, since houses are categorized on the basis of age, among other characteristics; 20-year-old houses sold in 1972 are compared to 20-year-old houses sold in 1973, for example.

This introduces a source of bias into the rent index, but it is unlikely that the major difference between the indexes can be explained by the treatment of depreciation.

A second possible explanation for the rent patterns in the most recent periods is that, during late 1971 and much of 1972, rents were controlled under Phase I and Phase II programs to fight inflation. However, the divergence between rent and homeownership costs was widening before 1971. In the last 2 years, rents have increased about as fast as the overall Consumer Price Index, while homeownership costs have increased only slightly faster.

Another possible explanation for the smaller increase in the rent index may come from changes in neighborhood amenities, such as local public services. Apartments are relatively more common in central cities, houses -- especially new houses -- in the suburbs. Crime, fire, and similar problems appear to be more serious in central cities, as discussed in Chapter 6; central city neighborhoods are therefore likely to be less desirable. This might cause overall rent averages to rise less than rents in suburbs. Also, if public services (such as education) deteriorate in the cities or even improve less rapidly than in suburbs, central city rents would rise less than would suburban rents.

²⁹New units are regularly added to the apartments included in the rent index, and old units dropped from the sample, but the new units are never substituted directly for the old ones. The depreciation problem arises because new units built in 1972 are not compared with new units built in 1971; instead, the 1972 price of the unit built in 1971 is compared to the 1971 price. This practice makes it easier to standardize for many characteristics of the apartment, but it does also mean that the unit is older each time it is priced, and the index is not adjusted for this depreciation.

The same would be true for prices of houses between central city and suburbs; however, to the extent that apartments are relatively more common in the city and houses more common in the suburbs, a relative improvement in public services in the suburbs would appear as an increase in the price of single-family houses relative to apartments in the Consumer Price Index. This phenomenon might also partially explain the increases in the prices of new houses relative to existing houses in recent years, since existing houses are more likely to be located in central cities.

For both reasons, the rent index may be too low. However, there is also one important reason why the home purchase index, and thus the cost of homeownership, may be too high, particularly in recent years. The purchase price of a house reflects expectations that prices will rise in the future, as well as the value of the housing services provided currently.

In a period of inflation, housing prices are likely to be high because home buyers expect that the house will be worth more in the future; they are buying an asset which they expect will appreciate in value. Rents, on the other hand, reflect only the value of the services currently provided, since leases are typically renegotiated at short intervals of a year or two; in some instances, rents are set month by month, without leases.

The price of a house is thus likely to overstate the cost of the housing services it provides in any short period of time, since the house is also an investment which is expected to appreciate in value. The rent index is a better measure of the actual price of current housing services alone, while the home purchase index is a better measure of expected future housing costs.

The differences between the indexes thus are partly caused by downward biases in the rent index and upward biases in the home purchase index. In periods of inflation, such as the present, the upward bias in the home purchase index is likely to create the greatest distortion in the measurement of housing costs.

Despite its limitations, the rent component of the Consumer Price Index is a reasonably reliable guide to the cost of housing for renters. This is especially true for changes in the index over relatively short periods of time, such as the last 5 years, because depreciation and possible

neighborhood changes are likely to have a smaller impact; their effects are likely to be gradual and cumulative over fairly long periods, for the Nation as a whole.

GEOGRAPHICAL PATTERNS OF RENT INCREASES

There are relatively few data on rent costs for different geographical areas, or for population subgroups. However, the Consumer Price Index does include a rent series for 25 large metropolitan areas, including most of the largest areas in the country. Table 12 shows the changes in the rent component of the Consumer Price Index for these 25 areas, for the 1967-1972 period. With the single exception of Honolulu, the increases are less than the increases in homeownership costs for the same areas as shown in Table 11. In most cases, the differences are substantial. Table 12 also shows per capita income for these areas over the 1966-1971 period; for all areas, incomes increased far more rapidly than did rents. The typical renter in each area was able to afford a better apartment or home in 1972 than he could in 1967.

When the pattern of rent increases is examined more closely, pronounced regional differences can be seen. The increases are much greater in Eastern and Western areas than they are in the Midwest and South. The seven areas with the greatest increases are all Eastern or Western areas; San Diego heads the list. The area with the smallest increase is Seattle, but the next five above it are located in the Midwest or South. By contrast, the changes in the cost of homeownership showed a much less marked regional pattern.

Other patterns in the rent data are less clear. There is some tendency for rent and income increases to be positively correlated, but the correlation is weak. Rent increases appear to be unrelated to size of the area, or its rate of growth.

RENTAL COSTS AND RENTAL VALUES

The rent index can be used to measure the extent of quality improvement for renters, in the same way that changes in the price indexes for owner-occupied housing were used to measure quality improvements for owners.³⁰ Table 13 compares the change in the actual rents paid by

³⁰See the section, "Housing Cost vs. Housing Value," earlier in this Chapter.

TABLE 12

CHANGES IN INCOME AND RENTS, 25 MAJOR SMSA'S

SMSA	PERCENT CHANGE IN THE RENT INDEX 1967-1972	PERCENT CHANGE IN PER CAPITA INCOME 1967-1971
ATLANTA	17.0	48.8
BALTIMORE	12.6	41.4
BOSTON	29.2	45.2
BUFFALO	20.1	38.8
CHICAGO	13.2	34.3
CINCINNATI	9.6	37.5
CLEVELAND	13.0	30.4
DALLAS	11.8	40.2
DETROIT	20.2	33.9
HONOLULU	27.7	49.2
HOUSTON	10.9	47.2
KANSAS CITY	10.7	40.3
LOS ANGELES	18.5	33.6
MILWAUKEE	17.9	31.5
MINNEAPOLIS-ST. PAUL	21.1	38.2
NEW YORK	27.2	40.5
PHILADELPHIA	24.4	36.5
PITTSBURGH	17.0	37.4
PORTLAND	17.4	35.2
ST. LOUIS	8.6	31.0
SAN DIEGO	33.6	40.6
SAN FRANCISCO	29.2	38.1
SCRANTON	26.1	43.3
SEATTLE	5.7	22.2
WASHINGTON, D.C.	18.6	42.1

SOURCE: DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, UNPUBLISHED DATA;
DEPARTMENT OF COMMERCE, SURVEY OF CURRENT BUSINESS, MAY 1973.

TABLE 13

RENTAL COSTS AND RENTAL VALUES, 1960 AND 1970

RENTERS BY HOUSEHOLD TYPE AND INCOME	(1) MEDIAN 1960 GROSS RENT	(2)* COST OF 1960 APARTMENT IN 1970	(3) MEDIAN 1970 GROSS RENT	(4) QUALITY IMPROVEMENT (3)-(2)	(5) PERCENTAGE QUALITY IMPROVEMENT (4)÷(2)
ALL RENTERS	71	85	108	23	27.1
HOUSEHOLD TYPE					
2 OR MORE PERSONS					
MALE HEAD, WIFE PRES.					
UNDER 45 YEARS	76	91	118	27	29.7
45-64 YEARS	75	90	114	24	26.7
65 YEARS AND OVER	68	82	102	20	24.4
OTHER MALE HEAD					
UNDER 65 YEARS	74	89	120	31	34.8
65 YEARS AND OVER	65	78	92	14	17.9
FEMALE HEAD					
UNDER 65 YEARS	69	83	106	23	27.7
65 YEARS AND OVER	66	79	93	14	17.7
1 PERSON HOUSEHOLDS					
UNDER 65 YEARS	61	73	97	24	32.9
65 YEARS & OVER	52	62	78	16	25.8
INCOME CLASS					
LESS THAN \$2,000	52	62	79	17	27.4
2,000-2,999	60	72	85	13	18.1
3,000-3,999	66	79	91	12	15.2
4,000-4,999	72	86	96	10	11.6
5,000-5,999	76	91	102	11	12.1
6,000-6,999	81	97	106	9	9.3
7,000-9,999	87	104	115	11	10.6
10,000-14,999	99	119	133	14	11.8

* COLUMN (1) MULTIPLIED BY THE CHANGE IN THE RENT COMPONENT OF THE CONSUMER PRICE INDEX, TAKEN FROM DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, HANDBOOK OF LABOR STATISTICS, 1972, TABLE 127.

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CENSUS OF HOUSING, 1960 AND 1970.

all renters, and by population subgroups of renters, to the change in the rent index, over the period 1960-1970.³¹ The 1960 median rent for the group is multiplied by the ratio of the 1970 rent index to the 1960 index, in Column 2; this measures the median rent that would have been required in 1970 for the same apartment that was occupied in 1960.

For renters as a whole as well as for every subgroup, the median rent actually paid (Column 3) has risen by much more than the median rent required for the same apartment; the difference (Column 4) is a measure of the improvement in quality over the decade. For all renters, for example, the quality improvement according to this measure was \$23 or 27 percent, from 1960 to 1970.

In general, quality improvements have been least for households headed by elderly persons, or for single-person elderly households, although such calculations indicate that even these groups have had improvements of at least 15 percent over the decade.

The figures by income class are especially impressive, since these classes have the same dollar income in both years, even though the cost of living rose by 31 percent. The improvement for each group is consistent, however, with the fact that the rent index rose by less than the cost of living over the period; a hypothetical household, with the same money income in both 1960 and 1970, chose to buy better housing as its price relative to other goods became cheaper. For groups which had the same real income in both years, the improvement is still more striking. For instance, the \$3,000-\$3,999 class in 1960 had about the same real income as the \$4,000-\$4,999 class in 1970; rental housing for the 1970 group was 21.5 percent better than for the 1960 group. Similarly, when the \$6,000-\$6,999 group in 1960 is compared with the \$7,000-\$9,999 group in 1970, housing improved by 18.6 percent.³²

³¹Data on rents actually paid are available only in the decennial Census of Housing, so comparisons for the last 2 or 3 years are not possible.

³²These groups are comparable on the basis of real income, using the midpoints of each group to represent income for the typical household in the group, as is conventional. The increase in real income for the lower group was 29.7 percent over the decade; for the higher group, it was 30.8 percent. Both are very close to the 31.1 percent increase in the Consumer Price Index.

When changes in rents are compared to changes in incomes, it appears that both have grown at about the same rate for population subgroups classified on the basis of household composition and age of the household head. Table 14 contains the rent-to-income ratios for renters as a whole and for these subgroups. Only one group shows a change of more than 1 1/2 percentage points in either direction. Of the nine categories, rent-income ratios have risen in five, declined in three, and are unchanged in one; nor is there any particular pattern to the changes. These patterns are consistent with the conclusion of recent studies on housing expenditure-income relationships, which is that expenditures increase approximately at the same rate as income.³³ The change for the renter group as a whole is primarily caused by changes in the composition of renters; there were more elderly renters with higher rent-income ratios in 1970 than there were in 1960.

When rent-income ratios for income groups are examined (Table 15), the pattern changes; rent-income ratios are up for all groups. This is caused in part by changes in the proportions of elderly and single-person households in the different income groups; single-person households, which typically have high rent-income ratios, comprised only 28 percent of those with incomes below \$5,000 in 1960, compared to 42 percent in 1970.

The income figures used in these comparisons are total income, rather than disposable income, which is not available in the Census statistics. Over the decade of the 1960's, the ratio of disposable to total income declined by about 2 percent, which would imply that rent-income ratios increase slightly more when disposable income is used than they do in Table 15. However, the differences are slight. Also, it is likely that rent-income ratios for the lowest income classes would be affected least by this adjustment.

Table 15 also shows that housing quality has improved for every income class between 1960 and 1970, using objective measures such as plumbing and crowding conditions.

³³Margaret G. Reid, Housing and Income, Chicago: University of Chicago Press, 1962, Frank de Leeuw, "The Demand for Housing: A Review of Cross-Section Evidence," Review of Economics and Statistics, February 1971.

TABLE 14

RENT - INCOME RATIOS, BY HOUSEHOLD COMPOSITION 1960 AND 1970

HOUSEHOLD COMPOSITION BY AGE	MEDIAN RENT- INCOME RATIO	
	1960	1970
MALE HEAD, WIFE PRESENT (2 OR MORE PERSONS)		
UNDER 45 YEARS	17.3	16.0
45-64 YEARS	15.4	14.0
65 YEARS AND OVER	23.6	23.6
OTHER MALE HEAD (2 OR MORE PERSONS)		
UNDER 65 YEARS	18.9	22.8
65 YEARS AND OVER	25.1	26.4
FEMALE HEAD (2 OR MORE PERSONS)		
UNDER 65 YEARS	29.4	30.4
65 YEARS AND OVER	28.4	27.6
ONE PERSON HOUSEHOLDS		
UNDER 65 YEARS	22.3	22.6
65 YEARS AND OVER	49.5	49.8

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CENSUS OF HOUSING, 1969 AND 1970.

TABLE 15

RENT - INCOME RATIOS AND RENTAL HOUSING CONDITIONS BY INCOME CLASS, 1960 AND 1970

INCOME CLASS	MEDIAN RENT - INCOME RATIO		PERCENT OF HOUSEHOLDS WITH CENTRAL AIR CONDITIONING		PERCENT OF CROWDED HOUSEHOLDS		PERCENT OF HOUSE HOLDS LACKING COMPLETE PLUMBING*	
	1960	1970	1960	1970	1960	1970	1960	1970
TOTAL	35.3	39.6	1.0	8.6	15.6	10.1	19.5	8.0
LESS THAN \$2,000	57.8	64.0	0.5	4.2	15.9	7.4	40.3	18.1
2,000 - 2,999	28.7	51.8	0.5	4.4	20.6	9.7	22.3	12.6
3,000 - 3,999	22.3	31.8	0.7	5.1	19.2	12.6		
4,000 - 4,999	18.3	26.7	0.9	5.8	17.5	13.1	10.9	8.2
5,000 - 5,999	16.6	22.4	0.9	6.8	16.2	12.9		
6,000 - 6,999	15.0	20.2	1.0	7.5	14.5	12.1	5.3	4.3
7,000 - 9,999	12.3	16.8	1.4	8.4	12.1	11.6		
10,000 - 14,999	10.2	12.7	2.6	11.8	10.9	10.1	2.8	1.8
15,000 AND OVER	6.7	9.0	5.5	19.3	8.4	8.4		

* INCOME CLASSES: LESS THAN \$2,000
2,000 - 3,999
4,000 - 5,999
6,000 - 9,999
10,000 AND OVER

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CENSUS OF HOUSING, 1960 AND 1970.

Households in all income classes had rising rent-income ratios and better housing. Indeed, it is correct to say that the households had higher rent-income ratios because they had better housing. Had renters been willing to occupy the same quality of housing in 1970 as they did in 1960, they could have reduced their rent-income ratios substantially, because median income of renters rose by over 50 percent during the decade, while the rent index component of the Consumer Price Index rose by only 20 percent.

The relatively small increases in rents and the improvement in housing quality for renters are especially important since renters are relatively more common among lower-income groups. Table 16 shows that about half of all households with incomes below \$6,000 are renters compared to 37 percent nationally. Information on these low-income groups is valuable, since the limited data on homeownership costs available by income group do not cover households with incomes below \$6,000 to any appreciable extent. This Chapter has little to say about homeownership costs for low-income households as a result. However, for the half of low-income families who are renters, the available data indicate that rent increases have not adversely affected them. These households usually occupy housing of lower quality than does the typical household, but the evidence on rental costs provides some verification of what one would expect -- that this is because they have low-incomes.

TABLE 16

RENTERS BY INCOME CLASS, 1970

INCOME CLASS	RENTER OCCUPIED UNITS AS PERCENT OF U.S. TOTAL
\$0 - \$1,999	50.8
2,000 - 2,999	49.1
3,000 - 3,999	49.7
4,000 - 4,999	49.7
5,000 - 5,999	49.0
6,000 - 6,999	46.9
7,000 - 9,999	38.7
10,000 - 14,999	27.4
15,000 - 24,999	19.5
25,000 AND OVER	15.5
TOTAL	37.1

SOURCE: DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CENSUS OF HOUSING, 1970.

APPENDIX A

THREE HOUSING COST INDEXES -- BUREAU OF LABOR STATISTICS, BUREAU OF CENSUS, BUREAU OF ECONOMIC ANALYSIS

There are three available indexes of the cost of houses. All show small increases in recent years, compared to factor prices, and compared to the overall "cost of homeownership" component of the Consumer Price Index. (See Table 17.)

The U.S. Bureau of Economic Analysis Index for single-family homes calculates the price of finished structures having set specifications, excluding land prices. This index shows an estimated price increase of 4 percent between 1967 and 1970 relative to the Consumer Price Index. The recent increase reverses a downward trend since World War II. A more comprehensive index, prepared by the Bureau of the Census, takes eight characteristics of new houses into account in estimating price increases. On the basis of these characteristics, new houses are subdivided into 35 categories for calculating the index. This index has increased by 5 percent relative to the Consumer Price Index since 1967. Finally, the "Home Purchase" series of the Consumer Price Index is based on FHA-insured houses, both new and existing; it subdivides houses only on the basis of size and age, and is thus less comprehensive than the Census index. This series has increased by 3 percent relative to the Consumer Price Index since 1967.

TABLE 17

THREE HOUSE COST INDEXES

YEAR	STRUCTURE COSTS (1)	HOUSING SALES PRICE INDEX (CENSUS) (2)	HOME PURCHASE INDEX (BLS) (3)
1963	1.02	.98	1.03
1964		.98	1.03
1965	1.01 (EST)	.99	1.03
1966	1.00	.99	1.00
1967	1.00	1.00	1.00
1968	1.02	1.01	1.00
1969		1.03	1.01
1970	1.04 (EST)	1.01	1.04
1971		1.02	1.03
1972		1.05	1.03

SOURCE: (1) DEPARTMENT OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, INDEX OF CONSTRUCTION COSTS. THE INDEX WAS ADJUSTED TO A 1967 BASE AND MADE RELATIVE TO THE CPI.

(2) CENSUS INDEX OF ONE-FAMILY SALES PRICES. TAKEN FROM DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, CONSTRUCTION REPORTS, SERIES C-25, AND MADE RELATIVE TO THE CPI.

(3) DEVELOPED BY DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, NATIONAL HOUSING POLICY REVIEW, BASED ON DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS DATA AND MADE RELATIVE TO THE CPI.

APPENDIX B

DATA USED FOR HOUSING COMPARISONS BY INCOME CLASS

There are few data on housing consumption by income class apart from that available in the decennial Censuses of Population and Housing. Unfortunately, housing cost increases have accelerated since 1967, so that comparisons of 1960 and 1970 data do not provide much information pertinent to the problem. Apart from the Census, the most comprehensive data are compiled by the Federal Housing Administration, which collects and publishes the characteristics of houses insured by FHA. From these data it is possible to compare housing purchases by income class over time.

Since only FHA-insured houses are involved, FHA data refer to a small fraction of all home purchases; moreover, these houses typically are less expensive than the average home, particularly the average new home. However, the data are appropriate in that they are used to compile the Consumer Price Index, which has shown the most rapid increase in housing costs. Therefore, calculations based on FHA data are more likely to reveal changes in housing consumption by the various groups studied; if anything, they will overstate the effects of increased housing costs.

It is important to choose carefully the income classes used to make comparisons. It would not be very useful, for example, to compare families earning the same dollar incomes in 1967 and 1972. Because prices increased substantially during this period, an income of, say, \$5,000 represented a much lower real income for a family living in 1972 than it did for a family living in 1967. Furthermore, average income increased substantially during this period so that even families having the same real incomes in the 2 years are not strictly comparable. Because the 1967 average real income is no longer the average real income in 1972, the family maintaining that income is no longer typical.

APPENDIX C

COST DATA BY GEOGRAPHICAL AREA

The Appraisal and Mortgage Risk Division of the Department of Housing and Urban Development regularly compiles data regarding changes in the cost of constructing a "typical" house in selected areas of the country. These data have been amassed for the years 1967-1972.

For each area, the "typical" house (defined in terms of such characteristics as floor area and type of building materials used in construction) was determined through interviews with builders, architects and appraisers. Once the typical house was identified, one specific house having these characteristics was chosen and the amounts of labor and materials used in its construction were determined. Although this specific house was selected to represent the typical house for the entire area, it may have been located within the city, in a suburb, or in a rural setting.

Based upon the quantities of various materials and labor used in its construction and upon price information obtained from subcontractors, contractors, and suppliers located in the area, the cost of constructing the specific representative house was estimated. This representative (or "typical") house was priced at more than one location within those areas showing substantial spatial variation in the prices of construction labor and materials.

After the initial pricing, the same house was priced 3 times yearly, thus measuring changes in the average cost of construction over time. When the FHA appraisers (in consultation with builders and architects) decide that housing characteristics have changed too much to permit valid comparison from one year to the next, a new representative (or "typical") home is identified and priced. For areas with a changed "typical" house, of course, housing prices before and after the change are non-comparable. In fact, the typical house changed in many areas between 1967 and 1972; Boston and Washington are among the areas excluded from analysis for this reason.

APPENDIX D

FHA LAND PRICE DATA

Included among FHA-insured mortgages is a group designated "Section 203(b)." These mortgages can be obtained for up to 97 percent of the property value and for terms as long as 30 or 35 years. They can be used to finance the purchase of one- to four-family homes, exclusively.

The FHA compiles considerable data about the characteristics of Section 203(b) homes and lots, both new and existing. In particular, data available for the years 1967-1972 include median lot size, median price of site, and median price of site per square foot. Moreover, these statistics are calculated for each of 44 selected Standard Metropolitan Statistical Areas.

FHA appraisers first try to estimate the market price of a particular residential housing site by finding an "equivalent" lot having a known value. (An "equivalent" lot is one having the same size, located in the same neighborhood, enjoying the same amenities, and having access to the same public facilities as the one being priced.) When a comparable, but not completely equivalent, lot is found, the appraiser must adjust the site's price as best he can to allow for its uniqueness. After estimating a market price for each of the Section 203(b) home sites, the median price, median lot size and median price of site per square foot can be calculated.

Ideally, a lot price index for a particular city would measure changes in the average cost of the same lot from year to year, but the FHA data refer to all lots which are sold in each year and, therefore, price a different sample of lots from year to year. Moreover, there is no attempt to determine whether the lots sold in one year are similar to those sold in any other. For example, one year's FHA sales may be more concentrated in the suburbs, the next year's in the central city; the lot prices reported do not make any adjustment for this difference. Other possible differences could arise from locational factors; lots may be closer to transportation facilities, on average, in one year than another; or located in more desirable neighborhoods; or nearer to the beach in coastal or Great Lakes cities; or on higher ground in cities with hills. When any

of these phenomena occur, the lot price per square foot will change, even though the price of the same site (or similar sites) does not change.

A related problem stems from the sampling procedure used to accumulate the data on which land prices are based. Specifically, the sample of lots for which size and price information is obtained is apportioned among sections of the city according to the percentage of Section 203(b) homes located in each. For example, if a particular city has five districts with say, 60 percent of the homes insured under Section 203(b) located in District A and 10 percent located in each of Districts B, C, D, and E, then 60 percent of the sample also would be taken from District A and 10 percent from each of the remaining Districts. A bias exists, however, in that lots in the sample include only those financed under Section 203(b). For example, for the particular city described above, if the price of site per square foot were one-half as high in District A as it is in District B, C, D, and E, and if only 40 percent of all new homes financed during the year were located there, the calculated median price (based on 60 percent of the Section 203(b) homes located in District A) would tend to understate the true median lot price.

The conclusion to be drawn from these considerations is that the data on price of land used in this Chapter are less reliable as a price index than are the other data used.

APPENDIX E

HOUSING EXPENDITURE-INCOME RATIOS

It is useful to examine two additional measures of housing cost even though they are somewhat arbitrary. The first measure is based on a widely used, albeit questionable, rule-of-thumb that a family cannot afford a house if its value exceeds 2 1/2 times the family's income. The median value of house purchased is then examined and it is asked what proportion of the population has incomes less than 40 percent of this amount. If the proportion grows through time, it is said that it is becoming more difficult for families to afford housing. This measure has an enormous number of weaknesses which are discussed in detail below, but, for what it is worth, the proportion was the same in 1972 as it was in 1967, 41.8 percent, although there were decreases in 1968 and 1969 and increases in 1970 and 1971.³⁴

The main problem is that the results obtained from this analysis are crucially dependent upon the assumptions underlying it. For example, using a "2 times" rule instead of a "2 1/2 times" rule increases from 41.8 to 55.7 the percent of families unable to "afford" the typical new house sold in 1972 whereas a "3 times" rule reduces the percentage of such families to 37.8 percent. Moreover, the trends over time change, depending on which rule-of-thumb is used; using the "2 times" rule, the proportion of families unable to "afford" the typical new house declines from 1967 to 1972; using the "3 times" rule, the proportion increases. Quite different rules may be appropriate for families which buy new homes for differing reasons, e.g., some seek to amass equity in a home while others simply want shelter. And different rules may be appropriate for the same family in periods of inflation and periods of price stability.

An alternative measure of housing cost is based on the median monthly housing expenditures by households. This measure includes the total mortgage payment, maintenance and repair expenses, hazard insurance, and fuel and utilities costs. Then, using the rule-of-thumb that a family should spend 25 percent of its income on housing, the monthly housing

³⁴Data for this conclusion are based on FHA-insured houses.

expense is multiplied by 48 to obtain the necessary or "qualifying" annual income. This is used to determine what proportion of the population cannot afford the "typical" house sold in that year. The proportion has risen from 53.5 percent in 1967 to 56.6 percent in 1972, although there has been a slight decline since 1970.

Here, again, the results of the analysis are crucially dependent on the assumptions being made. If one assumes that housing expense should constitute one-third of a family's income, then the proportion of the population required to spend more than this fraction in order to buy the median-priced house in 1972 drops to 39.3 percent. If 40 percent is used as the appropriate expenditure-income ratio, then the proportion of families above this ratio drops to 30.7 percent. Conversely, by assuming that only 20 percent of the family's income ought to go for housing, the proportion of families exceeding this percentage jumps to 70.6 percent. All of these ratios have risen slightly over the 1967-1972 period.

Regardless of which arbitrary rule is used, it remains difficult to interpret the statement that some percentage of families is unable to "afford" the median-priced new house sold. For example, the assertion that 41.8 percent of all United States families could not afford to buy the median-priced (or "typical") one-family new house in 1972 is dependent solely on the criterion that a family's income be at least 40 percent of the median purchase price of all new homes sold in that year. This does not say, however, that these families could not or did not buy a lower priced house, whether new or existing. Nor, is it known how many families were seeking to buy any house in 1972, much less one of the size and quality represented by the median-priced new house sold in that year. In short, to calculate a "qualifying" income level, by whatever rule, is implicitly to set an income level which all families should attain and/or to establish a standard house which all families should purchase. There is no economic basis for setting either standard.

In any case, these measures are consistent with the previous conclusions reached in this Chapter, despite the obvious deficiencies of the approach. The increase in the median price of a house has been about the same as the increase in the median level of income, which is reflected in the stability of the proportion of the population "unqualified" to purchase the median house. On the other hand, the increases in expenditures for real estate taxes,

maintenance and repairs, and fuel and utilities are reflected in the increase in the proportion who are required to spend more than 25 percent of their income, (or 20 percent, or 33 1/3 percent, or 40 percent) for housing. These are the same factors which have contributed to the increase in the "cost of homeownership" component of the Consumer Price Index.

POSTSCRIPT

NATIONAL HOUSING POLICY REVIEW

OPERATIONS AND PERSONNEL

The National Housing Policy Review was instituted by HUD Secretary James T. Lynn to serve as a basis for the housing policy recommendations promised by President Nixon in his State of the Union Message on Community Development of March 8, 1973. The Secretary assigned Michael H. Moskow, Assistant Secretary for Policy Development and Research, to guide the effort as his first priority. Working closely with Assistant Secretary Moskow were William Lilley III, Deputy Assistant Secretary for Policy Development; Rudolph G. Penner, Deputy Assistant Secretary for Economic Affairs; and James B. Hedlund, Administrative Assistant.

Input was solicited and received from numerous sources:

Five study teams comprised of over 100 analysts drawn from the Departments of Agriculture; Commerce; Health, Education, and Welfare; Housing and Urban Development; Labor; and Treasury; and the Veterans Administration; the Federal Reserve Board; the Federal Home Loan Bank Board; and the Office of Economic Opportunity;

The Office of Management and Budget, the Council of Economic Advisers, and the Domestic Council;

Members of Congress knowledgeable in the housing field and staff members of the related Congressional Committees;

Public and private interest groups which deal with housing matters, and private consultants;

The general public in response to a notice published in the Federal Register.

The five study teams were organized to deal with specific issues, as follows:

Team 1 focused on broad economic, social and political questions related to housing with the objective of determining the appropriate role of government;

Team 2 conducted a detailed analysis of the suspended subsidy programs;

Team 3 undertook a detailed analysis of non-subsidized Federal programs, including Federal tax policies affecting housing;

Team 4 identified possible alternatives to existing programs; and

Team 5 directed the data collection and statistical analysis needed for the Review by all teams.

The teams were interdisciplinary in approach and composition; they included both persons knowledgeable in housing programs and policies as well as those with expertise in other areas.

After the study teams completed their data gathering and analysis, their work was assembled and assigned to eight chapter teams. The chapter teams organized the material produced by the study teams, as well as the work conducted by outside contractors, and drafted the final report. The chapter teams responsible for this effort were: Chapter 1: Arthur S. Newburg; Chapter 2: John Betz, Harry Lenhart, Jack A. Meyer, and Harvey Weiner; Chapter 3: Ralph Bristol, Donald Edwards, and Ronald Utt; Chapter 4: Paul Burke, Frederick Eggers, Hugh Knox, David P. Lafayette, John Morrall, and Edgar Olsen; Chapter 5: Robert Brown, Gary Kane, and Robert Sangster; Chapter 6: Norris Evans; Chapter 7: Heather Aveilhe, Duane McGough, and Joseph Sherman; Chapter 8: John Simonson and John Weicher. Lisa Gerard contributed to Chapters 1, 2 and 5.

Preliminary drafts of this report were circulated for review and comment within HUD and to other Federal agencies and departments and revised in light of the recommendations received. Thus, this report represents a comprehensive effort to analyze and assess the past, present and future role of the Federal Government in housing.

NATIONAL HOUSING POLICY REVIEW

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